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In The

Supreme Court of the United States

October Term, 1993

RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware,

Petitioner,

v.

OLDE DISCOUNT CORPORATION,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a federal court may enjoin a state securities commissioner from ordering restitution for investor victims on the grounds that private parties have contracted away the state's enforcement remedy which is authorized by statute.

2. Whether a federal court, rather than abstain under the *Younger* doctrine, may enjoin a state securities commissioner from ordering restitution for investor victims in advance of the state's administrative hearing on the grounds that an alleged securities law violator's Federal Arbitration Act preemption claim is subject to an "immediate irreparable injury."

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PETITION FOR A WRIT OF CERTIORARI

The Delaware Securities Commissioner, Richard W. Hubbard, respectfully petitions this Court to grant a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Third Circuit in this case.[1]

[1] W. Michael Tupman, Eugene H. Engelhardt, and Carol D. Engelhardt were also parties to this action in the court of appeals. Petitioner does not believe that they have an interest in this petition. Petitioner, contemporaneous with the filing of this petition, has served upon them the notice required by SUPREME COURT RULE 12.4.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Third Circuit is reported at 1 F.3d 202 (3d Cir. 1993) and is reprinted in the Appendix at 1. The order of the court of appeals denying the securities commissioner's petition for rehearing is reprinted at App. 46. The opinion of the United States District Court for the District of Delaware, reported at 805 F. Supp. 1130 (D. Del. 1992), is reprinted at App. 48. The order of the district court enjoining the securities commissioner is reprinted at App. 75.

JURISDICTION

The opinion and judgment of the court of appeals affirming the district court's preliminary injunction were entered on July 30, 1993. (App. 1). A timely motion for rehearing was denied on August 26, 1993. (App. 46). This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). In granting the preliminary injunction against the securities commissioner, the district court determined that it had jurisdiction under 28 U.S.C. § 1331.

STATUTORY PROVISIONS INVOLVED

The two critical state and federal statutory provisions and the Supremacy Clause of the Constitution are stated below. Additional provisions of the Delaware Securities Act referenced in this petition are reprinted at App. 89.

Section 7325(b) of the Delaware Securities Act, as amended, DEL. CODE ANN. tit. 6, § 7325(b) (1992 Cum. Supp.), reads as follows:

> (b) The Commissioner may make, amend and rescind rules, regulations, forms and orders to carry out and define the provisions of this chapter. Such orders may provide for fines, assessment of costs, restitution to investors, conditional or probationary registration, censure or reprimand, special reporting requirements, or other provisions which the Commissioner determines to be in the public interest. Any person, whether registered or not, who wilfully violates any provision of this chapter, or who aids and abets any person who wilfully violates any provision of this chapter, may be fined in accordance with subsection 7316(g) and ordered to pay restitution and costs (or to rescind the transaction or transactions and pay costs) if the Commissioner finds it in the public interest, and may be criminally prosecuted under § 7322.

Section 2 of the Federal Arbitration Act, as amended, 9 U.S.C. § 2 (1970), reads as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

The Supremacy Clause of the United States Constitution provides that:

> This Constitution, and the Law of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST., art. VI, cl. 2.

STATEMENT OF THE CASE

On August 17, 1992, the Delaware Securities Division issued administrative charges against Olde Discount Corporation (Olde) and one of its agents alleging violations of the Delaware Securities Act (Act). (App. 7). The administrative complaint sought to suspend Olde's and the agent's registrations, impose fines for each violation of the Act, and rescind the underlying allegedly fraudulent sales. (App. 87). Eight days later, on August 25, 1992, without requesting a hearing on the administrative complaint, Olde filed an action in federal district court alleging violations of its federal rights by the Delaware securities commissioner and the Division's staff counsel. (App. 8). On September 16, 1992, the district court issued a preliminary injunction against the securities commissioner, enjoining him from seeking or ordering rescission on behalf of the complaining investors. (App. 8-9). The court ruled that because those investors had signed an arbitration agreement with Olde, the Federal Arbitration

Act (FAA) preempted the securities commissioner from seeking rescission as a remedy in his enforcement action. (App. 72-74). The commissioner appealed, and on July 30, 1993, a fragmented panel of the Court of Appeals for the Third Circuit, with one judge dissenting, affirmed. (App. 3) .

The record in this case consists of affidavits and supporting documents submitted within 48 hours of the filing of the original complaint and prior to the district court's hearing on Olde's motion for a temporary restraining order and preliminary injunction. (App. 49). On those documents, and without any live testimony, the district court in its memorandum opinion of September 16, 1992 made numerous findings of fact, some of which were erroneously labeled "undisputed."[2] (App. 49).

1. The Englehardts' Complaint

Olde Discount Corporation is a securities firm that maintains a branch office in Wilmington, Delaware. Olde has been registered as a broker-dealer in Delaware since October 1981. (App. 50). Although the firm holds itself out as a discount broker, it makes a market in many

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[2] For example, although the investors told the Securities Division investigator that the agent checked the investment objective of "speculation" without their knowledge after they had signed the account agreement, the court found as an undisputed fact that they had provided this information to the agent. (App. 51).

securities which its agents recommend to customers.[3] In 1983, Eugene and Carol Engelhardt opened a joint account with Olde in Michigan where they were then living. When the Engelhardts moved to Delaware in 1986, they transfered the account to Olde's office in Wilmington. (App. 50). In the spring of 1990, their account was assigned to Michael Donohoe, the sole agent and branch manager of the Wilmington office. (App. 50).

The administrative complaint alleged that Donohoe repeatedly recommended that the Engelhardts purchase common stock in a savings bank, Second National Federal Savings Bank (SNFS).[4] The Engelhardts, who were 56 and 50 years old, were initially reluctant to follow Donohoe's advice because they had invested most of their savings into certificates of deposit and some stocks personally selected by Mr. Engelhardt. (App. 81). Donohoe persisted, however, telling the couple that it was a local bank, and he was thus personally knowledgeable about the stock. Donohoe also said that the research report done by Olde's analysts gave the stock a "big buy recommendation." At another time, Donohoe told the Engelhardts that he had "inside knowledge" that SNFS was about to be bought by another bank. Donohoe went so far as to say, "I'll even waive the commission" to induce them to

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[3] The court of appeals' conclusion that Olde makes a market in only "a few selected stocks" is incorrect. (App. 4). An advertising brochure entitled "Modern Investing" that Olde sent to Delaware residents in or about August 1993 listed approximately 128 over-the-counter stocks in which Olde made a market.

[4] SNFS was a Maryland building and loan association until 1987, when it converted its charter to a federal savings bank.

make the purchase. (App. 82). Though Donohoe repeatedly sang the praises of SNFS, he did not tell the Engelhardts that Olde actually made a market in SNFS. (App. 83). Olde was thus on the other side of the transaction from the Engelhardts, selling the stock out of its own inventory with an undisclosed price mark-up. The apparently neutral recommendation from Donohoe was tainted by a conflict in interest, and the undisclosed fact that Olde was a market maker in the stock was a material omission in violation of DEL. CODE ANN. tit. 6, § 7303(2). (App. 83).

The Engelhardts were eventually won over by Donohoe's importuning. On May 15, 1990, they bought 2000 shares of SNFS stock at 5¼ per share for $10,622, and then an additional 3000 shares at 5⅜ for $16,308. Donohoe marked the trade tickets as "unsolicited." (App. 83). Ten days later, after the two initial purchases of SNFS stock, and several years after they had started doing business with Olde, the Engelhardts were asked by Donohoe to sign an "Investors Account Agreement," which they did. Prior to May 25, 1990, there was no written agreement. (App. 50).

2. The Arbitration Agreement And Further Sales

Although the signature portion of the Agreement, which was a single two-sided piece of paper, referred to a "Predispute Arbitration Clause," the actual arbitration clause was in the form of a printed brochure separate from the signature page. It provided that the investors had to submit "any and all controversies or claims arising

out of the relationship established by this agreement to arbitration to be conducted according to the rules and procedures of the New York Stock Exchange, Inc. (NYSE) or of the National Association of Securities Dealers, Inc. (NASD)." (App. 4).

After the intitial sales and the signing of the Agreement, Donohoe continued to urge the Engelhardts to purchase more SNFS shares. Donohoe claimed the thrift was "strong" and that he "knew of things going on," alluding to a potential acquisition of SNFS shares by another bank, which would make their purchase of SNFS shares "a really good deal." (App. 84). On Donohoe's recommendation, the Engelhardts bought another 5000 shares of SNFS common stock on June 6, 1990 at $5^1/_4$ per share for $26,250. Donohoe marked the trade ticket as "unsolicited." (App. 84).

Shortly thereafter, the stock price began to drop, and it continued to fall as SNFS lost $16 million in income during the quarter ending September 30, 1990. (App. 80). By the end of 1990, SNFS stated in its Form 10-K financial report that it was in violation of capital requirements and in danger of a regulatory takeover. (App. 81). During this period, Donohoe never apprised the Engelhardts of these events but, in response to a call from Mr. Engelhardt, encouraged them not to sell the stock. (App. 86). The Engelhardts lost most of the value of their investment as the share price of SNFS plummeted. (App. 80).

3. The Investigation, Draft Notice, And Settlement Negotiations

In July 1991, the Engelhardts filed a complaint with the Delaware Securities Division against Olde and Donohoe. (App. 52). The Division's investigator made written inquiries to Olde and Donohoe. (App. 52-53). After the investigation was completed in May 1992, the Securities Division staff counsel forwarded to Olde's counsel a draft of the "Notice of Intent To Suspend or Revoke Broker-Dealer Registration." (App. 53). The notice, which if filed would trigger an administrative proceeding, charged that Olde and Donohoe had engaged in fraudulent, dishonest, and unethical practices in connection with the sales of the SNFS stocks to the Engelhardts. (App. 83-85). In addition, it charged Olde with failing to supervise Donohoe reasonably. (App. 84, 86).

In an effort to settle the charges, counsel for Olde and the Securities Division discussed the complaint for several months. In July 1992, Olde offered a $20,000 settlement that would have paid the investors less than half of their investment loss.[5] (App.6). As negotiations broke down, Olde served a demand for arbitration on the Engelhardts. (App. 7). After the collapse of settlement efforts, the Securities Division staff counsel

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[5] The district court found that this offer would have fully compensated the Engelhardts for their loss during the period when they had an account with Olde, (App. 54, 56), overlooking the fact that there was subsequently no market for the stock, making it effectively worthless.

recommended that the administrative notice be issued.[6] On August 17, 1992, the commissioner issued the notice of intent to suspend or revoke the registrations of Donohoe and Olde in Delaware.[7] (App. 57).

4. Olde's Action And The Decisions Below

Rather than defend itself on the administrative charges, Olde filed an action in federal district court on August 25, 1992, naming the securities commissioner, staff counsel, and the investors as defendants. The original complaint alleged, *inter alia*, that Delaware's administrative rescission remedy was preempted by the FAA and

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[6] The district court found that the draft notice sought a $10,000 fine for each violation of the Act, (App. 53), but the notice that was issued on August 17, 1992 sought only a $1000 fine for each violation. (App. 87).

[7] The Delaware Department of Justice issued a brief press release on August 17 reporting the initiation of proceedings against Olde. A newspaper article appeared on August 18 in the Wilmington *News Journal*, and in response to that article, Securities Division staff received additional complaints similar to those made by the Engelhardts. On December 7, 1992, Securities Division staff counsel recommended the issuance of a second administrative complaint, charging Olde and Donohoe with further violations committed in the sale of SNFS stock to 17 investors in Delaware. Also on December 7, 1992, the commissioner issued the second notice of intent to suspend or revoke the registration of Olde and Donohoe. The violations alleged in the second notice involved conduct similar to that which was alleged in the first administrative complaint.

that Olde's federal civil rights were violated by the defendants.[8] (App. 8).

On the basis of affidavits submitted soon after the filing of Olde's complaint, the district court issued its September 16, 1992 memorandum opinion with detailed findings of fact concerning the investment by the Engelhardts and the settlement negotiations between Olde and the Securities Division staff attorney. (App. 48). The court accepted Olde's argument as to an identity of interest between the Engelhardts and the State, and the court enjoined the securities commissioner from seeking or ordering rescission on behalf of the Englehardts. (App. 71, 75). According to the district court, the FAA preempted § 7325(b) of the Delaware Securities Act, DEL. CODE ANN. tit. 6, § 7325(b) (1992 Cum. Supp.), as that statutory provision allowed the commissioner to order rescission on behalf of individual investors who had signed predispute arbitration agreements. (App. 74).

The defendants appealed the preliminary injunction to the Third Circuit Court of Appeals, which issued its decision on July 30, 1993.[9] (App. 1). The court split three

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[8] Subsequently, on January 26, 1993, the complaint was amended to allege violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968, by the Delaware Division of Securities, which was alleged to be a criminal enterprise that engages in criminal extortion.

[9] In the district court and on appeal the Delaware Department of Justice provided representation to the Engelhardts, as witness victims who were being sued, pursuant to its specific duty under 29 DEL. CODE ANN. §2504(9). Judge Greenberg thought this fact confirmed the "community of interest" between the Securities Division and the Engelhardts for purposes of preemption analysis. (App. 17).

ways: Judge Greenberg affirmed on the basis of preemption; Judge Rosenn concurred on the grounds that contract principles supported the district court's actions to prevent the Engelhardts from an "end run" to evade their contractual obligations; and Judge Nygaard dissented on the grounds that the Delaware statutory scheme made the commissioner's enforcement action in the public interest a different type of action than a civil suit by the Englhardts in their own interest. (App. 3). The panel agreed, however, that *Younger* abstention did not apply. (App. 3). The defendants then filed a petition for rehearing, which was denied on August 26, 1993. (App. 46).

As the preliminary injunction has been under appeal, the administrative action has been stayed for the past year while Olde pursues its RICO and civil rights claims on the other counts in the district court. The parties are now in the midst of discovery.

REASONS FOR GRANTING THE WRIT

This case presents a conflict between strong federalism concerns and arbitration rights under the Federal Arbitration Act (FAA): may private parties contractually invalidate a state regulatory agency's statutory remedy for securities law violations? Attempting to deal with this question, the court of appeals has issued a fractured, three-way decision that promises to confuse and mislead the other circuits. It is also a major departure from this Court's approach in the important areas of arbitration and abstention. The court of appeals' decision held that

the FAA precludes state regulators from seeking a remedy that would benefit a victim in the same manner as would an arbitration award. Ironically, two judges on the panel below agreed that the state agency was not preempted under the FAA; yet, the district court's injunction, which was based on preemption analysis, was affirmed. Moreover, the concurring opinion was grounded in contract law, but it ignored the most fundamental contract principle: an entity that is not a party or in privity with a party to a contract cannot be bound by the terms of the agreement.

The issues in this case extend beyond the administrative remedy in question and beyond the area of securities law. Four states have administrative restitution or rescission provisions similar to Delaware's.[10] Twenty-six other states have provisions in their securities acts specifically authorizing the agency to seek court-ordered rescission,[11] while three additional state statutes allow the agency to seek disgorgement.[12] Most of the remaining states have adopted § 408 of the Uniform Securities Act, 1 Blue Sky L. Rep. (CCH) ¶ 5548, allowing the agency to seek ancillary

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[10] *See* ARIZ. REV. STAT. ANN. § 44-2032(1) (1987) and ARIZ. COMP. ADMIN. R. & REGS. § 14-4-308; D.C. CODE ANN. § 2-2614 (1981); IND. CODE ANN. § 23-2-1-17.1(a) (Burns 1993 Cum. Supp.); and VA. CODE ANN. § 13.1-521(c) (1993).

[11] These states are: Alabama, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Mississippi, New Mexico, New York, North Carolina, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, and Wisconsin.

[12] *See* ARK. CODE § 23-42-209(b) (1987); MICH. COMPL. LAWS § 451.808(a) (1979); TENN. CODE ANN. § 48-2-119(b) (1988).

relief in connection with the granting of an injunction.[13] Such ancillary relief has been interpreted to include restitution and rescission.[14]

Since bank credit card agreements have begun to include arbitration clauses, the court of appeals' decision also bears directly on state consumer protection law. The rationale of the two affirming opinions below would apply to any consumer protection action brought by a state attorney general seeking restitution if the consumer victims had agreed to an arbitration clause.[15] It would also seem to extend to court-ordered restitution in a criminal case (for example, securities fraud under DEL. CODE ANN. tit. 6, § 7322, a different section of the same statute under which the Securities Division brought the instant administrative action). This important issue in federal law should not be determined by a confusing opinion that blatantly disregards this Court's holdings in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. ___, 111 S.Ct. 1647, 114 L.Ed.2d 26, 38, 41 (1991) (EEOC may prosecute action and seek equitable relief on basis of complaint that is also subject of arbitration); *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946) (restitution in the public interest is not the equivalent of damages

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[13] This Act has been adopted in 41 states and territorial jurisdictions. *See* 1 Blue Sky L. Rep. (CCH) ¶ 5500 (1992).

[14] *See, e.g., Porter v. Warner Holding Co.*, 328 U.S. 395 (1946); *Mitchell v. Robert De Mario Jewelry, Inc.*, 361 U.S. 288 (1960); *State ex rel. Day v. Southwest Mineral Energy, Inc.*, 617 P.2d 1334 (Okla. 1980). *See also* 12A J. LONG, BLUE SKY LAW § 9.05[6] (1992).

[15] Rescission is a form of restitution. D. DOBBS, REMEDIES 222 (1973). The petitioner interprets the district court's preliminary injunction as barring restitution orders generally.

sought by a private party, even where the facts are the same); *Kelly v. Robinson*, 479 U.S. 36, 52 (1986) (restitution distinguishable from damages judgment for private individual); *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627-28 (1986) (*Younger* abstention applies even where federal right would have to be asserted in state administrative proceeding); and *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 365 (1989) (preemption claim is no different than other constitutional claims for purposes of *Younger* abstention).

The Delaware Securities Act

Historically, the states have exercised their police powers to regulate securities to protect the investing public. "State securities laws, commonly referred to as 'blue sky' laws, were enacted long before the Securities Act of 1933, and Congress specifically preserved those laws instead of attempting to preempt the field from federal legislation." L. Loss & E. Cowett, Blue Sky Law 3 (1958). Both the Securities Act of 1933 and the Securities Exchange Act of 1934 expressly preserve the traditional rights of the states to regulate securities transactions within their own jurisdictions. *See* 1933 Act, 15 U.S.C. § 77r (1981); 1934 Act, 15 U.S.C. § 78bb(a) (1981 & 1992 Cum. Supp.). Accordingly, there is a presumption that in enacting the FAA, Congress did not intend to preempt the regulatory power of the states to enforce their securities laws to protect the public interest.

The Delaware Securities Act (Act) is a "blue sky" law which "with some specificity . . . requires registration of

securities offered or sold [in Delaware], states that certain representations are unlawful, creates a registration procedure for broker-dealers and investment advisors, and provides for administration by the Attorney General or a designated Deputy." *Singer v. Magnavox Co.*, 380 A.2d 969, 981 (Del. 1977). The purpose of the Act is "to prevent the public from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations." DEL. CODE ANN. tit. 6, § 7301(b). The statute contains one section that permits civil damages to a private litigant from a person who "offers, sells or purchases a security" by fraud. DEL. CODE ANN. tit.6, § 7323(a). In addition to that limited private civil cause of action, the Act creates an administrative regulatory scheme and bestows broad enforcement powers on the securities commissioner. "In the public interest," the commissioner may 1) seek an injunction in Delaware's Court of Chancery (§ 7320), 2) seek a criminal indictment (§ 7322), or 3) "by order deny, suspend, or revoke any registration" in an administrative proceeding (§ 7316). As a sanction for a proven state law violation, in an administrative proceeding under § 7316, the commissioner is authorized to impose, *inter alia*, an award of rescission or restitution in the public interest. DEL. CODE ANN. tit. 6, § 7325(b). Similarly, the Court of Chancery, in an injunctive proceeding brought by the commissioner, may order rescission or restitution when appropriate in the public interest. DEL. CODE ANN. tit. 6, § 7320. And, in any criminal prosecution under the Act, the Superior Court may

similarly order restitution to defrauded investors as part of the sentence. DEL. CODE ANN. tit. 6, § 7322(e).

In this case, the Securities Division initiated an administrative action under § 7316 and § 7325(b) before the commissioner. Although a private civil action under §7323 by investors (such as the Engelhardts) is precluded by an arbitration agreement under the FAA, the commissioner's public enforcement action under § 7316 and § 7325(b) should not be preempted.

I. The Court Should Grant The Writ To Clarify That A Federal Court May Not Enjoin A State Securities Commissioner From Ordering Restitution For Investor Victims On The Grounds That Private Parties Have Contracted Away The State's Enforcement Remedy Which Is Authorized By Statute.

The court of appeals' holding effectively creates a new, super-protected federal right to arbitrate. It overrides the *Younger* abstention doctrine as well as a statutorily-authorized remedy under a state regulatory scheme. This case marks the first time that FAA rights have been successfully asserted, not to deflect state interference with the arbitration forum,[16] but to assert the primacy of arbitration rights over any possible arguable

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[16] *See, e.g., Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 495 U.S. 956 (1990) (FAA held to preempt Massachusetts regulation prohibiting brokers from requiring investors to sign an arbitration agreement as condition of opening an account); *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988) (FAA held to preempt Pennsylvania Securities Act provision that precluded enforcement of agreement to arbitrate state law securities claims).

conflict in outcome between arbitration and a neutral state regulatory procedure. In this case, the Delaware statute did not even mention or address arbitration. Under the court of appeals' decision, the arbitration right is superior to all other contract rights and, indeed, to constitutional rights.

A. Restitution Is Not Equivalent To A Judgment For Damages.

Both the preemption and the "contractually bound" rationales of the two opinions which affirm the injunction rest on the unsound assumption that the rescission which the commissioner could order in the public interest is nothing more than the same remedy the Engelhardts could seek in an arbitration forum. As this Court has held, however, restitution in the public interest differs greatly from damages sought by private parties. *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946). Indeed, in *Porter* this Court upheld an award of restitution to overcharged tenants in an action by a government price control administrator even though the tenants themselves could not have brought their own actions to recover the same payments. The action undertaken in the public interest was not the same as a private cause of action. More recently, in *Kelly v. Robinson*, 479 U.S. 36, 52 (1986), this Court stated that even though "restitution does resemble a judgment 'for the benefit of' the victim, the context in which it is imposed undermines that conclusion. The victim has no control over the amount of the restitution awarded or over the decision to award restitution."

B. The Court Of Appeals' Departure From Gilmer.

The court of appeals' approach is also contrary to this Court's statement in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. ___, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991), that administrative agencies, enforcing the public interest, are free to pursue issues and fashion remedies even though the transaction in question may also fall within an arbitration agreement. This Court held in *Gilmer* that an arbitration agreement between a securities representative and his employer required the employee to arbitrate a statutory claim under the Age Discrimination in Employment Act (ADEA); but the contractual clause did not preclude the employee from filing a complaint with the Equal Employment Opportunity Commission (EEOC) alleging the same statutory violation, nor did it "preclude the EEOC from bringing actions seeking class-wide and equitable relief." 114 L.Ed.2d at 41. This is because "the ADEA is designed not only to address individual grievances, but also to further important social policies." *Id.* at 38. Thus, "[a]n individual ADEA claimant subject to an arbitration agreement will still be free to file a charge with the EEOC, even though the claimant is not able to institute a private judicial action." *Id.*

Like the EEOC, the Delaware securities commissioner "does not function simply as a vehicle for conducting litigation on behalf of private parties." *Occidental Life Insurance Co. v. EEOC*, 432 U.S. 355, 368 (1977). *See also General Telephone Co. v. EEOC*, 446 U.S. 318, 326 (1980) ("When the EEOC acts, albeit at the behest of and for the benefit of specific individuals, it acts also to vindicate the

public interest in preventing employment discrimination."). The commissioner acts on behalf of the public when he awards restitution or rescission in favor of a defrauded investor. Such remedies, as they return the parties to the *status quo*, help to deter and eliminate the harmful consequences of securities fraud. These objectives are explicitly defined as part of the "public interest" by the Delaware General Assembly in the Delaware Securities Act. DEL. CODE ANN. tit. 6, § 7301(b). While these remedies may give an incidental compensatory benefit to the individual investors, such relief does not give them control of the regulatory action or make their interests equivalent to the State's broader interest in protecting the investing public from securities fraud. Under the Delaware scheme, the private investors do not control whether their complaint will be investigated, whether a prosecution will eventually be initiated, what remedies the Division will seek, or what remedies the commissioner and reviewing courts may impose. Suits by government regulators "frequently have specific private as well as public beneficiaries," but the "touchstone remains the fact that public policies are served and the public interest is advanced by the litigation, and the fact that the litigation has private beneficiaries as well does not detract from the public nature of the suit." *Dole v. Local 427*, 894 F.2d 607, 612 (3d Cir. 1990).

C. Rescission Does Not Render The Arbitration Agreement Meaningless.

The gist of the two affirming opinions in the court of appeals is that the contractual right to arbitrate will be

meaningless if the Delaware commissioner in a regulatory action may order rescission on the same facts that might be the basis of an arbitration. That view is incorrect, however, legally and practically. From a legal perspective, the agreement to arbitrate runs only against those who were parties to the contract. From a practical perspective, a brokerage firm may still derive a substantial benefit from an arbitration agreement even if it remains subject to state-ordered rescission in the public interest.

The great benefit of an arbitration agreement is the savings in the cost of litigating in an arbitration forum rather than in a judicial lawsuit. This benefit is especially valuable to a large brokerage firm with many clients. Inevitably, such a firm will be faced with meritless claims based on the fact of a client's loss and nothing more. These are the sort of claims that, if they end up in prolonged court battles, can financially damage a business significantly regardless of the level of care taken by its managers. The state regulators, however, exercise a screening function to weed out the frivolous complaints, the sour grapes, and the fodder for nuisance suits. Unlike private attorneys who may see a large contingency fee in these meritless complaints, the state regulators have no personal financial interest in advancing them. Thus, the real benefit of an arbitration agreement as a practical matter is its effect on litigation initiated by private parties, not on actions which may be initiated by state government officials. It is appropriate that the scope of this practical benefit be limited to those who have agreed to it, the private parties themselves.

D. The Right To Arbitrate Is Equal, Not Superior, To Other Contract Rights.

The FAA was intended by Congress "to make arbitration agreements as enforceable as other contracts, but not more so." *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 404 n.12 (1967). The FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms." *Volt Information Sciences, Inc. v. Stanford University*, 489 U.S. 468, 478 (1989).

One of the most elementary of contract principles is that a third party not in privity to a contract between two others is not bound by the terms of their agreement. Here, the securities commissioner never agreed to be bound by the terms of any contract between Olde and the Engelhardts. Moreover, the commissioner and the Engelhardts were not in privity, nor did they have an identity of interest. The court of appeals mischaracterized the administrative proceeding, saying that it was "initiated on the complaint of the Engelhardts," and that the State "is pursuing" civil claims "on behalf" of the Engelhardts. (App. 17). In fact, the Engelhardts' complaint triggered only an investigation by the Securities Division. The Division made the decision whether to file a notice (with the commissioner's approval), and the commissioner and reviewing state courts would make the decision whether an order of rescission would be necessary to protect the public interest. As Judge Nygaard stated in dissent, "[T]he Delaware statutory scheme makes clear that the Commissioner is not a surrogate for

a plaintiff's attorney, but is a public official who administers the state's blue sky laws 'in the public interest' and is endowed with broad enforcement and rulemaking powers." (App. 38, citing *Blinder, Robinson & Co. v. Bruton*, 552 A.2d 466, 475 (Del. 1989).)

E. There Is A Strong Public Interest In The Remedies Of Rescission And Restitution.

Although the lower courts have focused on the remedy of rescission, the Olde arbitration agreement itself did not. Rather, the contract stated that "any and all controversies or claims arising out of the relationship" had to go to arbitration. (App. 4). On its face, this language would extend to any hearing involving the same factual dispute as would be involved at an arbitration. Both lower courts in this case have held, however, that this language does not preclude a hearing that would result in a finding that Olde and Donohoe violated the Delaware Securities Act and in the imposition of a license suspension or a fine, but does preclude making the victims whole. The logic of this distinction, permitting parallel proceedings for some sanctions but not restitution, is elusive. This Court has held that a public interest inheres in the remedy of restitution just as it does in the remedies of a license suspension or a fine. *See Kelly v. Robinson*, 479 U.S. 36, 52 (1986); *Porter v. Warner Holding Co.*, 328 U.S. 395, 402 (1946).

Not only does case law support the view that restitution is a necessary enforcement remedy that advances the public interest, but practical considerations do as well. The public interest may be better served by reducing or

avoiding the more severe sanction of a license suspension or revocation. If a state securities administrator's hands are tied by the federal courts with respect to making victims whole through an order of restitution, brokerage firms may risk a greater chance of receiving a license suspension or, if restitution is available only in criminal prosecutions, of being prosecuted criminally. Through their flawed decision, the federal courts will have skewed decisionmaking among state securities regulators in a manner detrimental to the public interest.

II. The Court Should Grant The Writ To Clarify That A Federal Court May Not Enjoin A State Securities Commissioner From Ordering Restitution For Investor Victims In Advance Of The State's Administrative Hearing On The Grounds That An Alleged Securities Law Violator's Federal Arbitration Act Preemption Claim Is Subject To An "Immediate Irreparable Injury."

This case illustrates the utter disregard by the Court of Appeals for the Third Circuit of the *Younger v. Harris*, 401 U.S. 37 (1971), abstention doctrine, especially as it was articulated by this Court in *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627-28 (1986), and *New Orleans Public Service, Inc. v. Council of City of New Orleans*, 491 U.S. 350, 365 (1989) (*NOPSI*). In the instant case, the court of appeals has held that *Younger* abstention is discretionary even when all elements that normally counsel abstention are present. (App. 25). Moreover, the court of appeals has effectively violated this Court's instruction in *NOPSI* that preemption claims

are to be treated no differently than other constitutional claims for purposes of abstention under *Younger.*

To avoid application of the *Younger* doctrine, here the court of appeals carved out a new exception for FAA preemption claims. The court tried to avoid the impact of *NOPSI* by asserting that that decision "did not confront a collision between the normal application of *Younger* principles and the highly favored right to arbitration which the [Supreme] Court itself has developed in FAA cases. . . . "(App. 30). Thus, even though this Court views preemption claims as similar to other constitutional claims for abstention purposes, the court of appeals thinks this principle does not apply to FAA claims that possibly have merit. Apparently, in its view, the right to arbitrate has acquired a status that is superior to such rights as due process and equal protection. Reaching for authority for this anomalous proposition, the court of appeals cites *Wooley v. Maynard,* 430 U.S. 705 (1977), to assert that this case is the "very unusual situation" where "an injunction is necessary to prevent great and immediate irreparable injury." (App. 25, quoting *Dayton Christian Schools,* 477 U.S. at 626). The great and immediate irreparable injury, it seems, is the fact that Olde would have to assert its FAA preemption defense at the state administrative proceeding and in the reviewing state courts. However, this Court in *Dayton Christian Schools* held that this type of alleged injury is insufficient to avoid application of *Younger* abstention. 477 U.S. at 627-28.

CONCLUSION

For the foregoing reasons, this Court should grant this petition for a writ of certiorari.

Respectfully submitted,

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APPENDIX

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Filed July 30, 1993

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 92-7557

OLDE DISCOUNT CORPORATION

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT and CAROL D. ENGELHARDT,

W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT, CAROL D. ENGELHARDT,

Appellants

On Appeal from the United States District Court
for the District of Delaware

(D.C. Civil No. 92-00498)

Argued June 10, 1993

BEFORE: GREENBERG, NYGAARD, and ROSENN,
Circuit Judges

(Filed: July 30, 1993)

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OPINION

GREENBERG, *Circuit Judge.*

This case presents a novel question of the relationship between a contracting party's right to enforcement of an arbitration agreement under the Federal Arbitration Act, 9 U.S.C. §§ 1-16 (FAA), and a state's interest in pursuing a remedy of rescission in an administrative proceeding. The district court enjoined the Delaware securities commissioner from seeking rescission on behalf of two investors who had entered into a predispute arbitration agreement. We will affirm the district court's order. Judge Greenberg votes to affirm on the grounds that the FAA preempts Delaware's rescission remedy in these circumstances and this opinion reflects the reasons why he has reached this conclusion. Judge Rosenn votes to affirm on the ground that the rescission remedy is barred by reason of contract law as set forth in his separate concurring opinion. Judge Nygaard dissents on this issue for the reasons set forth in his separate opinion. We unanimously hold that this claim, *i.e.*, that a state statute is preempted to the extent it authorizes relief in conflict with rights secured by the FAA, necessarily falls within an exception to the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746 (1971).

I. BACKGROUND

Appellee Olde Discount Corporation, a securities broker-dealer, is a Michigan corporation with its principal

place of business in Detroit and numerous offices throughout the United States. Olde Discount is registered in Delaware as a broker-dealer and has an office in Wilmington. Appellants Eugene and Carol Engelhardt are former customers of Olde Discount. The Engelhardts, then Michigan residents, opened a brokerage account with Olde Discount's Detroit office in 1983. When they moved to Wilmington in 1986, the Engelhardts transferred their account to its Wilmington office.

Olde Discount is primarily, as its name implies, a discount broker. It also makes a market in a few selected stocks; at the times relevant to this action, Second National Federal Savings Bank (SNFS) was among those stocks. Allegedly at the instance of Olde Discount's Wilmington office manager, Michael Donohoe, the Engelhardts purchased 5,000 shares of SNFS stock on May 15, 1990. On May 25, 1990, the Engelhardts signed an account agreement with Olde Discount that required them "to submit any and all controversies or claims arising out of the relationship established by this agreement to arbitration to be conducted according to the rules and procedures of the New York Stock Exchange, Inc. (NYSE) or of the National Association of Securities Dealers, Inc. (NASD). . . . " Investors Account Agreement, ¶ 18, J.A. at 53. Also on May 25, 1990, the Engelhardts provided Olde Discount with a "customer preference profile" that expressed their interest in "aggressive" investments for the purposes of "growth" and "speculation." J.A. at 48. On June 6, 1990, the Engelhardts purchased an additional 5,000 shares of SNFS. Thus, by early June 1990, the Engelhardts had purchased 10,000 shares of SNFS. These purchases cost the Engelhardts over $50,000.

The price of SNFS stock declined steadily during the summer and fall of 1990, as the bank suspended its dividend and came under the scrutiny of federal regulators because it failed to fulfill capital requirements. The Engelardts, apparently because of their bad experience with this investment, terminated their Olde Discount brokerage account and removed their SNFS shares from Olde Discount on September 6, 1990. By then the Engelhardts' SNFS stock had declined in value to approximately $32,500.

Nearly a year later, in July 1991, the Engelhardts first contacted the Division of Securities of the Delaware Department of Justice with a complaint about their purchase of SNFS stock from Olde Discount. The Division, primarily through appellant Michael Tupman, a Delaware Deputy Attorney General responsible for securities law enforcement, investigated the Engelhardts' complaint. In early June 1992, after the Division substantially had completed its investigation, it sent Olde Discount a draft "Notice of Intent to Suspend or Revoke Broker-Dealer Registration." The draft Notice of Intent alleged that Olde Discount and its agent Donohoe had engaged in fraudulent and unethical practices in connection with the sales of SNFS stock to the Engelhardts, in violation of Del. Code Ann. tit. 6, §§ 7303(2) and 7316(a) (1974 & Supp. 1992).

In particular, the Notice asserted that Donohoe repeatedly had urged the Engelhardts to invest in SNFS and had made false statements of material fact about the stock. Further, the Notice alleged that Olde Discount had not kept the Engelhardts advised of information that could have been pertinent to their decision whether to

hold or sell the stock. The Notice indicated that the Delaware securities commissioner sought the remedies of suspension or revocation of Olde Discount's broker-dealer registration and imposition of fines; and, central to the preemption question in this case, that the commissioner would seek rescission of the SNFS stock transactions between Olde Discount and the Engelhardts, as authorized by Del. Code Ann. tit. 6, § 7325(b). The Notice, however, did not suggest that either Olde Discount or Donohoe had violated any duty to customers other than the Engelhardts; the Notice thus proposed individual relief for the Engelhardts only.

During the summer of 1992, the Division of Securities and Olde Discount tried to negotiate a settlement of the proposed charges. Ultimately Olde Discount, desiring to bring the settlement negotiations to fruition, offered to pay $15,000 to the Delaware Investors Protection Fund and to pay $20,375 to the Engelhardts.[1] The proposed payment to the Engelhardts represented the difference between the total price they had paid for the SNFS stock, and its value of approximately $32,500 on September 6,

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[1] In their opening brief, the appellants asserted that the district court's consideration of events that occurred during settlement negotiations was contrary to Fed. R. Evid. 408, which prohibits the admission of "[e]vidence of conduct or statements made in compromise negotiations. . . . " However, as counsel for Olde Discount has noted, the appellants have not preserved this evidentiary point because they did not object to the introduction of these facts before the district court. In any event, these facts are background information, helpful to an understanding of the context of the dispute; they are not critical to our disposition, as we anchor our result on legal principles.

1990, when the Engelhardts had closed their brokerage account with Olde Discount.

The appellants do not dispute that Tupman agreed in principle to accept $15,000 in partial settlement of the Division's proposed charges. Nevertheless, Tupman insisted that Olde Discount also must rescind the Engelhardts' SNFS purchases. This demand was not acceptable to Olde Discount, which apparently had consistently maintained that the securities commissioner could not properly pursue a rescission, because Olde had a contractual right to arbitrate the Engelhardts' claims. Tupman, however, viewed Olde Discount's claims of its contractual right to arbitration and of the federal preemption of Delaware's rescission remedy as "baffling." *See* Tupman's August 7, 1992 letter to Olde Discount, J.A. at 111. He consequently would not abandon the demand that it rescind the SNFS sales to the Engelhardts.

Olde Discount determined to pursue its right to arbitration, and served the Engelhardts with a demand to arbitrate on August 5, 1992. Shortly thereafter, on August 17, 1992, Tupman issued the Notice of Intent in substantially the same form as the June 1992 draft, *i.e.*, including the demand for rescission of the Engelhardts' SNFS transactions. Notice of Intent, ¶ 43, J.A. at 139. The Notice provided that Olde Discount would be entitled to a hearing before the Delaware securities commissioner if it made a written request within 30 days. However, if Olde Discount did not request a hearing, the allegations would be deemed admitted and the commissioner would issue a final order of suspension, revocation, rescission, fine and/or costs.

On August 25, 1992, Olde Discount commenced this action against Tupman, Delaware Securities Commissioner Richard W. Hubbard, and the Engelhardts. The complaint's four counts alleged that: (1) the rescission remedy of Del. Code Ann. tit. 6, § 7325(b), as applied by the defendants, circumvents Olde Discount's rights under the FAA and thus violates the Supremacy Clause; (2) the application of Del. Code Ann. tit. 6, § 7325(b), to Olde Discount's transactions with the Engelhardts in SNFS stock would constitute an *ex post facto* punishment in violation of the Due Process Clause;[2] (3) Tupman and Hubbard had violated 42 U.S.C. § 1983 by employing the Delaware securities laws in a manner that impaired Olde Discount's federal constitutional and statutory rights; and (4) Tupman's actions constituted a common law abuse of process. Olde Discount sought an injunction, a declaratory judgment, compensatory damages, and punitive damages.

Olde Discount most immediately was concerned with preserving its federal right to arbitration of the Engelhardt dispute. It therefore vigorously pressed for a preliminary injunction to halt further proceedings before the Delaware Division of Securities. After expedited briefing and argument, the district court, by order dated September 16, 1992, accompanied by a comprehensive memorandum opinion, partially granted Olde Discount's motion for preliminary relief, enjoining "the Securities

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[2] Olde Discount contends that at the time of its transactions with the Engelhardts, Delaware law did not provide for a rescission remedy in proceedings concerning suspension or revocation of the registration of a broker.

Commissioner[] [from pursuing] a rescission action under [Del. Code Ann. tit. 6, § 7325(b)] on behalf of defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. §2." In its opinion, the district court determined that the FAA preempted the Delaware rescission remedy. Furthermore, the district court declined to abstain under *Younger* from issuing injunctive relief. Tupman, Hubbard, and the Engelhardts jointly appealed from the September 16, 1992 order, contending that the district court "erred as a matter of law" both in declining to abstain under *Younger* and in holding that the rescission remedy was preempted.

II. JURISDICTION AND STANDARD OF REVIEW

Before turning to the merits of the preemption and abstention issues, we must resolve a challenge to our jurisdiction raised by Olde Discount. It argues that the appeal is from an interlocutory order "directing arbitration to proceed," which is specifically nonappealable under 9 U.S.C. § 16(b)(2). However, contrary to Olde Discount's characterization, the district court's order in this case is not an order "directing arbitration to proceed." Rather, the district court directed the Delaware securities commissioner not to pursue a remedy of rescission in the administrative proceedings. Thus, the order falls within the usual rule of 28 U.S.C. § 1292(a)(1), which permits immediate appeals from "[i]nterlocutory orders . . . granting [or] refusing . . . injunctions."

Our review of a determination regarding preliminary injunctive relief is limited to examining whether the district court abused its discretion, committed an obvious error in applying the law, made a clear mistake in considering the proof, or improperly applied the law to the facts. *Kreimer v. Bureau of Police of Morristown*, 958 F.2d 1242, 1250 n.9 (3d Cir. 1992); *Philadelphia Marine Trade Ass'n v. Local 1291, Int'l Longshoremen's Ass'n*, 909 F.2d 754, 756 (3d Cir. 1990), *cert. denied*, 111 S.Ct. 953 (1991). This standard requires a plenary review here, as the appellants contend that the district court erred as a matter of law in entering the injunction. We also exercise plenary review over the abstention question because we are resolving that issue by making a legal determination. *General Glass Indus. Corp. v. Monsour Medical Found.*, 973 F.2d 197, 200 (3d Cir. 1992); *Gwynedd Properties, Inc. v. Lower Gwynedd Township*, 970 F.2d 1195, 1199 (3d Cir. 1992).

III. PREEMPTION

The Supremacy Clause allows Congress to preempt state legislation if it so intends.[3] *See United States Dep't of Treasury v. Fabe*, 61 U.S.L.W. 4579 (U.S. June 11, 1993). The development of the law of federal preemption has defined three ways of discerning a congressional intent to preempt state law: express or explicit preemption, implied preemption, or "actual conflict" preemption. The

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[3] While as a matter of convenience this section of the opinion entitled "III. PREEMPTION" is written as if for the court, it in fact is the opinion only of Judge Greenberg.

Supreme Court thus has differentiated among the three types of preemption:

> Congress explicitly may define the extent to which its enactments pre-empt state law. . . . In the absence of explicit statutory language, however, Congress implicitly may indicate an intent to occupy a given field to the exclusion of state law. Such a purpose properly may be inferred where the pervasiveness of the federal regulation precludes supplementation by the states, where the federal interest in the field is sufficiently dominant, or where 'the object sought to be obtained by the federal law and the character of obligations imposed by it . . . reveal the same purpose'. . . . Finally, even where Congress has not entirely displaced state regulation in a particular field, state law is pre-empted when it actually conflicts with federal law. Such a conflict will be found ' "when it is impossible to comply with both state and federal law . . . or where the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress. . . . " '

Schneidewind v. ANR Pipeline Co., 485 U.S. 293, 299-300, 108 S.Ct. 1145, 1150-51 (1988) (citations omitted).

The preemption claim before us is that the FAA demands enforcement of an agreement to arbitrate which cannot be abrogated by a state agency's pursuit of an administrative remedy that would duplicate the remedy sought in an arbitration. Section 2 of the FAA, 9 U.S.C. § 2, directs the enforcement of arbitration agreements as broadly as Congress' powers under the Commerce Clause permit:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Olde Discount contends that the FAA's directive compels enforcement of the arbitration clause of the Engelhardts' account agreement. Thus, if the Delaware securities commissioner pursues rescission in the administrative proceeding, Olde Discount's federal right to arbitration would be impaired, as the merits of the claim that the arbitration agreement reserves for an arbitral forum will be resolved administratively.

Yet it is clear that the FAA does not explicitly preempt any particular remedy that might be sought in state administrative proceedings. Nor does the FAA entirely occupy the field of securities regulation so as to give rise to implied preemption; to the contrary, both the Securities Act of 1933 and the Securities Exchange Act of 1934 specifically preserve the traditional rights of the states to regulate securities transactions within their own jurisdictions. *See, e.g.*, 1933 Act, 15 U.S.C. § 77r ("[n]othing in this subchapter shall affect the jurisdiction of the securities commission . . . of any State or Territory . . . over any security or any person"); 1934 Act, 15 U.S.C. § 78bb(a) ("[n]othing in this chapter shall affect the jurisdiction of the securities commission . . . of any State over any

security or any person insofar as it does not conflict with the provisions of this chapter"). In fact the FAA is not concerned in particular with securities regulation as 9 U.S.C. § 2 deals generally with contracts involving commerce. Therefore, to preserve its right to a meaningful arbitral forum Olde Discount relies on the third type of preemption, "actual conflict" preemption.

There can be "actual conflict" preemption in two circumstances, either where it is impossible to comply with the conflicting demands of federal and state statutes, or where the state law is an "obstacle" to the fulfillment of the congressional purposes embodied in the federal law. *See, e.g., Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 83 S.Ct. 1210 (1963) (holding federal regulation concerning maturity of avocados did not preempt California regulation, where it was not impossible for growers to comply with both regulations); *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 404 (1941) (holding federal Alien Registration Act preempted Pennsylvania Alien Registration Act because state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"); *Pennsylvania Medical Soc'y v. Marconis,* 942 F.2d 842, 848 (3d Cir. 1991) (holding Pennsylvania statute governing limited aspects of Medicare billing not preempted by federal Medicare Act because state statute did not create obstacle to fulfillment of Congress' objectives). As our analysis of the interaction between the Delaware administrative rescission remedy and Olde Discount's arbitration agreement with the Engelhardts will make clear, both factors indicating conflict preemption, conflicting statutory demands

and an obstacle to Congress' purposes, are present in this case.

The context of this preemption claim, *i.e.*, the preservation of a federal right to an arbitral forum, is critical. At one time other substantive and procedural rights of parties were thought to outweigh a right to arbitration. *See Wilko v. Swan*, 346 U.S. 427, 74 S.Ct. 182 (1953) (stating Securities Act of 1933 precluded waiver of judicial forum, rendering arbitration agreement invalid). But that time is no more. *See Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S.Ct. 1917 (1989) (overruling *Wilko v. Swan*). The Supreme Court unstintingly has promoted a favorable climate for arbitration through vigorous enforcement of the FAA over the last 20 years. The gradual erosion of the principles of *Wilko v. Swan* began with the 1974 decision of *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 94 S.Ct. 2449, which held that a claim under the Securities Exchange Act of 1934 would be arbitrable in the distinctive context of an international business transaction. The international character of the dispute was also an important consideration in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 105 S.Ct. 3346 (1985), which upheld an order compelling submission of Sherman Act claims to arbitration in Japan. More generally, *Mitsubishi* noted that there is "no warrant in the Arbitration Act for implying in every contract within its ken a presumption against arbitration of statutory claims." *Id.* at 625, 105 S.Ct. at 3353.

The Court moved beyond the specialized international context and enforced arbitration of 1934 Act claims and RICO claims, pursuant to a clause in a standard brokerage agreement, in *Shearson/American Express, Inc. v.*

McMahon, 482 U.S. 220, 107 S.Ct. 2332 (1987). Shortly thereafter, the Court resolved the inconsistency between *McMahon* and *Wilko* by expressly overruling *Wilko* in *Rodriguez de Quijas*. Two Terms later, the Court extended the ascendancy of arbitration beyond commercial disputes to age-discrimination claims in *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S.Ct. 1647 (1991), which rejected the contention that the involvement of an agency, there the Equal Employment Opportunity Commission, in a scheme of enforcement created any impediment to the private arbitration of the claims arising in a particular case.

Two aspects of the development of the federal right to arbitration that we have traced are particularly noteworthy here. First, the arbitration of securities disputes now is not only permitted, but favored, under federal law, according to the line of decisions culminating in *McMahon* and *Rodriguez de Quijas*. *See also Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508 (3d Cir. 1988) (stating FAA preempts provision of Pennsylvania Securities Act purporting to preclude enforcement of agreements to arbitrate state law securities claims). Second, there is no longer any doubt that statutory claims are arbitrable, and the existence of an enforcing agency, as in *Gilmer*, does not interfere with the arbitrability of individual claims. Similarly, it is clear that state statutory claims, as well as federal statutory claims, are subject to the federal right to an arbitral forum. *See Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852 (1984) (holding FAA preempts California statutory provision requiring judicial forum for claims under California Franchise Investment Law); *Osterneck v. Merrill Lynch*, 841 F.2d at 512-13.

Thus, the claims that the Delaware Division of Securities is pursuing on behalf of the Engelhardts, *i.e.*, claims of fraudulent dealings in violation of Del. Code Ann. tit. 6, § 7303, certainly would be subject to arbitration if pursued by the Engelhardts themselves. *See* Del. Code Ann. tit. 6, § 7323 (creating private right of action for securities fraud). However, the appellants argue that for preemption purposes we must distinguish between the advancement of essentially identical claims on the basis of whether their proponent is a state agency or a private litigant. The appellants contend that the state's enforcement action implicates the public interest, and not simply the rights of the Engelhardts. Further, the appellants cite *Gilmer* for the proposition that "arbitration agreements will not preclude [an administrative agency] from bringing actions seeking class-wide and equitable relief." 111 S.Ct. at 1655. In the appellants' view, the agency's pursuit of "equitable relief" sanctioned in *Gilmer* should include the remedy of rescission of specific trades of securities sought in this case. The appellants view the rescission remedy as an integral component of the state's regulation of securities transactions which, they argue, should not be weakened by the application of federal preemption.

However, we think the rescission remedy as applied here necessarily would render Olde Discount's right to arbitration meaningless. The particular remedy therefore must fall before the conflicting right to an arbitral forum granted by the FAA. The FAA's fundamental purpose was to create "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24, 103 S.Ct.

927, 941 (1983). "In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 U.S. at 10, 104 S.Ct. at 858. Yet the Delaware Division of Securities claims that it must be permitted to adjudicate administratively the very same questions regarding Olde Discount's sale of SNFS stock to the Engelhardts, that the Engelhardts themselves could pursue only within an arbitration. In that regard, Delaware has interfered with Olde Discount's right under the FAA to resolution of these issues through arbitration. Therefore, in the application here of the rescission remedy of Del. Code Ann. tit. 6, § 7325(b), Delaware has created an "obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. at 67, 61 S.Ct. at 404.

The very community of interest between the state appellants and the Engelhardts implicitly demonstrates that the administrative proceedings are an obstacle to Congress' purpose in adopting the FAA. Clearly the Engelhardts are relying on the state appellants to obtain a remedy that would frustrate the arbitration. As the appellants acknowledge, the administrative proceedings were initiated on the complaint of the Engelhardts. Indeed, the Notice of Intent issued to Olde Discount was concerned exclusively with dealings between Olde Discount and the Engelhardts. Furthermore, Tupman filed this appeal on behalf of the Engelhardts, who are not represented by separate counsel on appeal, and were not so represented in the earlier settlement negotiations with Olde Discount.

In the circumstances, the state administrative proceedings, to the extent they concern claims and liabilities between the Engelhardts and Olde Discount, are nothing other than a substitute for the arbitration.

The circumstance that the state appellants are not parties to the arbitration clause does not alter our result. As the Supreme Court explained in *Moses H. Cone Memorial Hospital*, "[u]nder the Arbitration Act, an arbitration must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." 460 U.S. at 20, 103 S.Ct. at 939. In partial reliance on *Moses H. Cone*, we recently upheld a district court's eviction of a subtenant to facilitate an award arising from an arbitration between the property owner and the tenant, even though the subtenant was not a party to the arbitration. *See Isidor Paiewonsky Assocs. v. Sharp Properties, Inc.*, No. 92-7337 (3d Cir. June 24, 1993).[4]

It is also apparent that, in any practical sense, Olde Discount cannot simultaneously arbitrate its claims against the Engelhardts and defend against the Delaware securities commissioner's pursuit of the rescission remedy in an administrative proceeding. Notwithstanding the appellants' statement that they will not, and cannot, prevent Olde Discount from commencing the arbitration, the appellants' view of a possible harmonious interaction of the state and federal statutes is illusory. While in a physical sense Olde Discount could be represented in two

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[4] We are not suggesting that an award in an arbitration proceeding would be preclusive in administrative proceedings; that issue is not presented by this appeal.

proceedings at once, the potential for actual conflict in that scenario is manifest. If an arbitration panel decides that the Engelhardts' claims are without merit and Olde Discount has no liability to them, while the Delaware securities commissioner concludes that the SNFS purchases must be rescinded, the results of the proceedings will be irreconcilable.

Even if the two proceedings were to reach similar results on the merits, Olde Discount still would be deprived of its right to the presumed simplicity and efficiency of the arbitral forum. Thus, to the extent rescission is involved, it is impossible to fulfill the demands of both the federal and state statutes. Therefore, Delaware's pursuit of the rescission remedy is preempted by the FAA both because Del. Code Ann. tit. 6, § 7325(b) presents an obstacle to the accomplishment of the congressional purpose of enforcing arbitration agreements, and because it is impossible to give effect to both the administrative rescission remedy and the federal right to arbitration.

We also reject the appellants' contention that an administrative rescission remedy is not preempted because *Gilmer* sanctions "equitable relief" by an agency despite a parallel arbitration of private claims. First, *Gilmer* on its facts did not address a question of equitable relief and its statements thereon are not dispositive of how the Supreme Court might resolve an actual controversy involving private arbitration and an agency's "equitable" remedies. Second, we believe the precise statement in *Gilmer, i.e.*, "that arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief," 111 S.Ct. at 1655, was meant to draw a distinction between private remedies

available in arbitration for one employee, versus remedies available through an action of the EEOC for a group of employees. In other words, the reference in *Gilmer* to class-wide equitable relief apparently was directed toward a situation where the EEOC could bring its enforcement powers to bear against an employer violating the law in its dealing with numerous employees by, for example, seeking an injunction on behalf of a class of employees against future acts of age discrimination. The analog in our case would be that the Delaware Division of Securities, if convinced that Olde Discount has committed widespread violations beyond those alleged in relation to the Engelhardts' stock purchases, is free to protect Delaware investors by imposing fines or licensing restrictions on Olde Discount, regardless of the progress or outcome of any arbitration of the Engelhardts' claims.[5] Thus, there is no foundation for appellants' assertion that *Gilmer* establishes that the state's interest in the "equitable" remedy of rescission should be given special exemption from standard preemption principles.

While our analysis might be different if a finding of preemption were to work a substantial interference with

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[5] It is conceivable that in the case of widespread violations of uniform character, *e.g.*, the distribution of fraudulently issued securities, individualized relief for members of a victimized class of customers might be possible notwithstanding the presence of arbitration agreements, on a theory that the violation did not arise from the particular relationship between the customer and the broker. We, of course, state no opinion on that possibility as it is not before us. In this case, the Notice of Intent was predicated on Olde Discount's and Donohoe's alleged individual maltreatment of the Engelhardts, which the Notice described in great detail.

traditional state objectives of securities law enforcement, that is not the case here. The district court did not enjoin the Delaware securities commissioner from investigating Olde Discount or from pursuing administrative remedies other than rescission of the Engelhardts' purchases. Accordingly, Delaware may take whatever action it sees fit consonant with federal law, concerning Olde Discount's state registration as a broker-dealer.[6] Delaware is also free to pursue individualized remedies, including rescission, as to securities transactions not subject to arbitration agreements.[7] Delaware therefore retains many avenues for the exercise of its proper role in dealing with alleged violations of its securities laws. Accordingly, federal preemption of the rescission remedy for investors

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[6] On December 7, 1992, the Division of Securities initiated a second proceeding against Olde Discount and Donohoe by reason of alleged improprieties in their dealings with other investors in SNFS stock. We are not concerned with those proceedings in this opinion.

[7] Although the appellants seem not to have stressed this point before the district court, the Engelhardts' initial purchase of 5,000 shares of SNFS stock on May 15, 1990, was before they signed the account agreement containing the arbitration clause on May 25, 1990. The district court did not take this sequence of events into account in reaching its result and neither will we as there is no issue as to the arbitrability of disputes arising from that purchase before us on this appeal. Nevertheless the district court's order of September 16, 1990, by its terms enjoins the commissioner from pursuing a rescission remedy for the May 15, 1990 purchase of SNFS stock. Thus, we do not preclude the appellants on remand from seeking an order modifying the preliminary injunction so as to exclude that purchase.

who have agreed to arbitration will narrow but not eliminate the state regulators' choices of means of enforcement of the Delaware securities laws.[8]

IV. ABSTENTION

The appellants argue, aside from the merits of the preemption question, that the district court should have abstained from granting an injunction that will interfere with Delaware's ongoing administrative proceedings against Olde Discount. The district court concluded that the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, was not applicable to Olde Discount's preemption claim under the FAA. We agree with the district court's resolution. Indeed, the circumstances presented make clear that a nonfrivolous claim of FAA preemption of a state statutory remedy necessarily presents an exception to the *Younger* doctrine.

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[8] The amici curiae in their brief contend that the district court's opinion could have a major impact in "the criminal law area" because of an increasing tendency for courts to impose restitution as part of a sentence. They suggest that if we affirm the district court's order, the state "could not seek nor could the court grant such relief where the defendant had entered into an arbitration agreement with his victims." Brief at 8. We, of course, cannot rule on what the law would be in the situation the amici describe. However, it is apparent that a case involving a criminal conviction is distinguishable from that involved here. In this case the administrative proceeding was in part brought for the express purpose of obtaining a rescission remedy. On the other hand, a criminal case is brought to determine whether a defendant is criminally liable and, if so, to fix the penalty for the violation.

Younger established that, despite the assertion of claims based on the federal constitution or federal statutes, a federal court should not enjoin pending state proceedings where three elements are present: (1) the ongoing state proceedings are "judicial" in nature; (2) the proceedings implicate important state interests; and (3) the proceedings afford an adequate opportunity to raise the federal claims. *Middlesex County Ethics Comm. v. Garden State Bar Ass'n*, 457 U.S. 423, 432, 102 S.Ct. 2515, 2521 (1982). Nevertheless, the Supreme Court has emphasized that a court should abstain only in rare cases.

> The doctrine of abstention . . . is an extraordinary and narrow exception to the duty of a District Court to adjudicate a controversy properly before it. Abdication of the obligation to decide cases can be justified under this doctrine only in . . . exceptional circumstances. . . .

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. at 14, 103 S.Ct. at 936 (quotation marks omitted).

The Court recently reiterated the exceptional quality of abstention in *New Orleans Public Service, Inc. v. Council of New Orleans*, 109 S.Ct. 2506 (1989). The Court noted that abstention is confined to rare circumstances because it runs counter to "the proposition that federal courts lack the authority to abstain from the exercise of jurisdiction that has been conferred. . . . 'They cannot abdicate their authority or duty in any case in favor of another jurisdiction.' " *Id.* at 2512-13 (quoting *Chicot County v. Sherwood*, 148 U.S. 529, 534, 13 S.Ct. 695, 697-98 (1893)). Those principles enunciated in *New Orleans Public Service* guided our approach in *Gwynedd Properties, Inc. v. Lower Gwynedd Township*, 970 F.2d 1195. In *Gwynedd*, mindful

that "a federal court has no authority to abstain from the exercise of jurisdiction that has been properly conferred," *id.* at 1199, we partially reversed the district court's dismissal of a complaint alleging federal constitutional claims concerning municipal land use regulatory decisions that were concurrently the subject of state court and municipal zoning board proceedings.

Notwithstanding the strict limits of abstention, the doctrine, where appropriate, forbids injunctive interference with state administrative proceedings as well as state court proceedings, though *Younger* itself forbade an injunction against a state criminal prosecution. In *Middlesex County Ethics Committee,* which upheld a district court's refusal to enjoin a state bar disciplinary proceeding on the grounds that the New Jersey Supreme Court would review the plaintiff's federal constitutional claims, the Court made explicit that "[t]he policies underlying *Younger* are fully applicable to noncriminal judicial proceedings when important state interests are involved." 457 U.S. at 432, 102 S.Ct. at 2521. In *Ohio Civil Rights Commission v. Dayton Christian Schools, Inc.,* 477 U.S. 619, 106 S.Ct. 2718 (1986), the Court again endorsed *Younger* abstention in relation to an ongoing state administrative proceeding. In that case, a religious school sought a federal injunction on First Amendment free exercise grounds against the state's investigation of a sex-discrimination complaint. The Court found that the third requisite of the *Younger* doctrine, availability of an opportunity to raise federal claims, was provided because the school's "constitutional claims may be raised in state-court judicial review of the administrative proceeding." *Id.* at 629, 106 S.Ct. at 2724.

It is therefore clear that conceptually *Younger* abstention can apply to the situation raised by Delaware's administrative proceedings against Olde Discount. The investigation and pending hearing by the Delaware securities commissioner is an ongoing state proceeding, "judicial" in nature, within the meaning of *Younger, Middlesex County,* and *Dayton Christian Schools.* Delaware's proceeding also undoubtedly serves the important state interest of regulating securities transactions, insofar as such power of regulation is reserved to the states under both the Securities Act of 1933 and the Securities Exchange Act of 1934. *See* 15 U.S.C. §§ 77r, 78bb(a). Finally, even if the Delaware Division of Securities has reached a conclusion that its pursuit of a rescission remedy is not preempted by the FAA, under *Dayton Christian Schools* it would be sufficient that Olde Discount could raise its preemption arguments again in a review of the administrative proceedings by the Delaware Court of Chancery. *See* Del. Code Ann. tit. 6, § 7324(a).

However, our conclusion that this situation formally fits within a *Younger* framework does not end our abstention inquiry, for *Younger* abstention is not always appropriate even if its elements are present. Thus, if "a genuine threat of prosecution exists, a litigant is entitled to resort to a federal forum to seek redress for an alleged deprivation of federal rights." *Wooley v. Maynard,* 430 U.S. 705, 710, 97 S.Ct. 1428, 1433 (1977); *see also Dayton Christian Schools,* 477 U.S. at 626, 106 S.Ct. at 2722 (interpreting *Younger* to prevent injunctions against state proceedings "except in the very unusual situation that an injunction is necessary to prevent great and immediate irreparable injury"); *Harmon v. Forssenius,* 380 U.S. 528, 537, 85 S.Ct.

1177, 1183 (1965) (stating that district court properly refused to abstain "[g]iven the importance and immediacy of the problem, and the delay inherent" in awaiting guidance from state courts). We addressed a similar situation of immediate need for intervention by a federal court in *Ford Motor Co. v. Insurance Commissioner*, 874 F.2d 926 (3d Cir. 1989). There, various insurers brought a preemption challenge to a Pennsylvania statute that prohibited the insurers from owning interests in savings and loan institutions. We applied the counsel of *Wooley v. Maynard* to articulate an exception to the *Younger* doctrine for state civil as well as criminal proceedings, in instances where "deference to the state proceeding will present a significant and immediate potential for irreparable harm to the federal interests asserted." *Id.* at 932.

Delaware's insistence upon the rescission remedy presents just such an immediate potential for irreparable harm to Olde Discount's right under the FAA to an arbitral forum. The Delaware regulators have chosen to stand firm in their pursuit of administrative rescission despite Olde Discount's repeated invocation of the FAA, its efforts to commence an actual arbitration with the Engelhardts, and the district court's suggestion that the issue of rescission could be bifurcated from the state's determination concerning other proposed remedies.[9]

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[9] Tupman, appearing for the State at the district court's August 27, 1992 hearing, rejected any separation of the rescission question from the State's broader proceedings:

> THE COURT: Mr. Tupman, just a comment or two. I do have a question for you:

Indeed the very nature of arbitration demonstrates the irreparable harm Olde Discount faces, for its right to arbitration is a contractual right sanctioned by statute, to have claims addressed in a particular forum. Thus, if the district court abstained in this case it would not simply be declining to exercise its statutorily created jurisdiction, which is the usual consequence of abstention. Rather, it would be refusing to protect Olde Discount's access to the forum that it and the Engelhardts contractually selected to resolve their disputes.

Furthermore, Olde Discount's right to arbitration cannot be satisfied if an alternate administrative forum is determining at the same time whether a claim to the identical remedy is available. The concern underlying a federal right to enforcement of arbitration agreements is a party's entitlement to a proceeding and a forum that are, at least ideally, speedy, efficient, and simpler than litigation in the courts or before agencies. *See Rodriguez de Quijas*, 490 U.S. at 479-80, 109 S.Ct. at 1919; *Mitsubishi*, 473 U.S. at 628, 105 S.Ct. at 3354. Therefore, in the context of

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> Aside from Paragraph 42 of your notice of intent to suspend or revoke, is there any reason why the public regulatory part of the Commission's prosecution can't be bifurcated from the [rescission] remedy . . . ?
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> MR. TUPMAN:. . . . [S]ince the statute and the General Assembly do clearly contemplate that all of this will be resolved in a single administrative proceeding, I don't think that it is – serves any interest, since, as we contend there's no impairment of the arbitration agreement. If they want to go to arbitration, they can go to arbitration. I can't stop them.

Supplemental App. at 92-93.

arbitration, a litigant's procedural right to the agreed forum is raised to a substantive right by the FAA. Accordingly, if Olde Discount were forced to address rescission of its sales to the Engelhardts in an administrative proceeding, even if it simultaneously could pursue an arbitration, it would suffer an immediate, irreparable harm to the federal right established by the FAA.

We find authority that *Younger* abstention would be inappropriate here in *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852. In *Southland* the Supreme Court determined to take jurisdiction over the appeal precisely because of the immediacy of the harm suffered by a party denied a right to arbitration. The California Supreme Court had held that the FAA did not preempt a California statute requiring a judicial forum for certain franchise claims, and had remanded the case to the state trial court for a disposition on the merits. Despite the remand, which arguably rendered the state court's decision not final, the Supreme Court took jurisdiction, reasoning that "[c]ontracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate," 465 U.S. at 6-8, 104 S.Ct. at 856-57. In this case, abstention would have precisely the same consequence, *i.e.*, it would permit the Engelhardts' claims to be brought before the Delaware securities commissioner, thus circumventing the agreement to arbitrate. We think *Southland* teaches that the federal courts ought not countenance such frustration of the FAA's mandate.

We also point out that abstention in this case would be difficult to justify in light of the congressional intent

reflected in 9 U.S.C. § 16. That section provides that while orders compelling arbitration are not immediately appealable, orders denying motions to compel arbitration or to stay judicial proceedings pending arbitration are immediately appealable. This dichotomy reflects the paramount importance that Congress has placed on arbitration. In effect, Congress has given the courts of appeals broad authority to ensure that district courts are not circumscribing the rights granted by the FAA in a manner contrary to the expansive enforcement of arbitration clauses that has been dictated by Congress itself and by the Supreme Court in, *e.g.*, *McMahon*, *Rodriguez de Quijas*, and *Gilmer*.

We are mindful that generally a claim of federal preemption, in and of itself, is not entitled to more deferential treatment than other constitutional claims in the face of an abstention challenge. The Supreme Court said as much in *New Orleans Public Service:*

> There is no greater federal interest in enforcing the supremacy of federal statutes than in enforcing the supremacy of explicit constitutional guaranties, and constitutional challenges to state action, no less than preemption-based challenges, call into question the legitimacy of the State's interest in its proceedings reviewing or enforcing that action. Yet is clear that the mere assertion of a substantial constitutional challenge to state action will not alone compel the exercise of federal jurisdiction.

109 S.Ct. at 2516.

In *New Orleans Public Service*, the Court ultimately found that the district court should not have abstained.

However, the Court did not conclude that simply because the case implicated findings of the Federal Energy Regulatory Commission which preempted a decision of local rate-making authorities, a blanket exception to *Younger* principles was warranted. *See also Ford Motor Co.*, 874 F.2d at 934 ("there is no absolute rule prohibiting the application of *Younger* abstention doctrine whenever the Supremacy Clause is invoked").

But in *New Orleans Public Service*, the Court did not confront a collision between the normal application of *Younger* principles and the highly favored right to arbitration which the Court itself has developed in FAA cases from *Scherk v. Alberto-Culver* through *Rodriquez de Quijas* and *Gilmer*. The collision is imminent in the present case, and we must resolve it by application of the Supreme Court's FAA cases and the Court's recognition in *Wooley v. Maynard* that, even when the *Younger* doctrine strictly might be applicable, a threat of immediate, irreparable harm to federal rights can warrant an injunction against state proceedings. We think that where, as here, a state agency is engaged in a course of action openly inconsistent with a litigant's rights under Section 2 of the FAA, that litigant cannot be turned away from federal court by an invocation of *Younger* abstention. This very narrow exception to *Younger* will not create difficulties in cases involving frivolous or weak claims of FAA preemption, because such claims would not meet the traditional requisites for injunctive relief and thus will not even require a district court to reach a *Younger* challenge.[10]

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[10] In its opinion, the district court cited *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 800 (3d Cir. 1989), with

We make one final point. A district court's decision to abstain does not necessarily mean that a federal court will never consider the proffered federal claim. Rather, abstention delays the review by a federal court until a state forum has had an opportunity to pass on the issue. For example, if a criminal prosecution is claimed to violate federal free speech, free exercise, or due process rights, a defendant not satisfied by the state court's resolution of those claims ultimately can seek a federal forum by petition for certiorari or petition for writ of habeas corpus. In most – indeed, nearly all – circumstances in which the elements of *Younger* abstention are present, *Younger* counsels that such a delay is an appropriate price to pay for the preservation of comity between the federal government and the states.

In the context of arbitration, however, delayed enforcement destroys the federal statutory right. It would be incongruous if abstention, merely a prudential doctrine, could have such a consequence. In our case, the district court correctly did not abstain because the Delaware regulators' repeated rejection of Olde Discount's FAA preemption claim already ensured that the right to

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respect to the general showing that must be made for an applicant for a preliminary injunction to obtain relief. The appellants' brief is not cast in terms of whether the criteria have been met but instead focuses on the preemption and abstention issues. The brief of the amici, however, does discuss the *Instant Air Freight* criteria. In these circumstances, we will not discuss these criteria in detail but simply will indicate that in view of our conclusions we agree that the district court properly issued the preliminary injunction.

arbitration would be lost, absent a federal court's intervention. Accordingly, despite the rule of *Dayton Christian Schools* that a right to an ultimate state court appeal of agency action suffices to support *Younger* abstention, we hold that where Section 2 of the FAA provides the basis for a federal preemption claim, a district court may not abstain, but must address the merits of the FAA claim.

V. CONCLUSION

In view of the aforesaid and Judge Rosenn's concurring opinion, we will affirm the district court's order of September 16, 1992, and will remand the case to the district court for further proceedings.

ROSENN, *Circuit Judge*, concurring.

Although I agree with the majority's conclusion that the Delaware Securities Commissioner cannot seek rescission as a remedy under 6 Del. C. § 7325(b), I write separately because I arrive at this result by way of contract law rather than the doctrine of preemption.

When Congress enacted the Federal Arbitration Act (FAA), it rejected the traditional hostility of the courts towards arbitration as a remedy in civil disputes and emphasized a strong federal policy in favor of arbitral dispute resolution in cases where a contract exists evidencing a transaction involving commerce. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985). In *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213

(1985), a case similar to the one *sub judice* in that it involved a dispute over a purchase of securities through a broker-dealer, the Court held that the FAA requires district courts to compel arbitration of pendent arbitrable claims, even where the result would be the possible inefficient maintenance of separate proceedings in different forums. The Court observed:

> The preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered, and that concern requires that we rigorously enforce agreements to arbitrate . . . at least absent a countervailing policy manifested in another federal statute. By compelling arbitration of state-law claims, a district court successfully protects the contractual rights of the parties and their rights under the Arbitration Act.

Id. at 221.

Significantly, the Court dwelt upon the necessity of enforcing the contractual rights of the parties under the agreement to arbitrate, also observing that "arbitration is not a judicial proceeding." *Id.* at 222 (citing *McDonald v. West Branch*, 466 U.S. 284 (1984)). Thus, the right of a party to enforce an arbitration agreement under the FAA depends not upon the federal doctrine of preemption, but upon the traditional duty of the courts to protect the contractual rights of the parties.

In the present case, Olde's investors' account agreement with the Engelhardts contained a provision stating:

> You agree to submit any and all controversies or claims arising out of this agreement to arbitration to be conducted according to the rules and

> procedures of the New York Stock Exchange, Inc. (NYSE) or the National Association of Securities Dealers, Inc. (NASD) as you may elect. . . .

The agreement further provides, "The parties are waiving their right to seek remedies in court, including the right to a jury trial."

Recently, in *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S. Ct. 1647, 1652 (1991) (citations omitted), the United States Supreme Court stated:

> It is by now clear that statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA. . . . [B]y agreeing to arbitrate a statutory claim, a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum.

Therefore, Olde and the Engelhardts lawfully bound themselves by the provisions of the agreement to arbitrate claims arising out of their securities transactions.

As noted by the majority, section 7325's remedy of rescission would interfere with the contractually created arbitration agreement in this case. To the extent that the Englehardts attempted an "end run" around the terms of the arbitration agreement by seeking relief in a state administrative proceeding, the district court properly restrained them. Federal courts will not "permit a party to a contract to circumvent an arbitration clause by commencing litigation in a state court." *In re Mercury Constr. Corp.*, 656 F.2d 933, 941 (4th Cir. 1981).

> Finally, the mere involvement of an administrative agency in the enforcement of a statute is not sufficient to preclude arbitration. For

> example, the Securities Exchange Commission is heavily involved in the enforcement of the Exchange Act of 1934 and the Securities Act of 1933, but we have held that claims under both of these statutes may be subject to compulsory arbitration. See McMahon; Rodriguez de Quijas.

Gilmer, 111 S. Ct. at 1653.

My disagreement with the majority stems from my belief that the district court's injunction should not be based on preemption doctrine, but rather the law of contracts. The fundament of Olde's right to settle the Engelhardts' demand for rescission of the securities transaction by arbitration is the arbitration provision contained in the investors' account contract, not the application of the doctrine of preemption.

"[F]ederal pre-emption of state law can occur in three types of situations: where Congress explicitly pre-empts state law, where pre-emption is implied because Congress has occupied the entire field and where pre-emption is implied because there is an actual conflict between federal and state law." *Pokorny v. Ford Motor Co.*, 902 F.2d 1116, 1120 (3d Cir. 1990) (citing *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293 (1988)), *cert. denied*, 498 U.S. 853 (1990).

The FAA "contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration." *Volt Info. Sciences, Inc. v. Stanford University*, 489 U.S. 468, 477 (1989). Nor has Congress occupied the entire field of securities regulation. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 135 (1973). The FAA, therefore, preempts a state securities

law only "to the extent that it actually conflicts with federal law." *Volt*, 489 U.S. at 477.

In the case *sub judice*, however, the federal law and the state law do not conflict. The Delaware Statute does not even deal with arbitration, which is the subject of the FAA. Rather, the conflict in this case arises between the state statute, as it relates to rescission, and the parties' contractually created right to arbitrate disputes relating to the securities transaction. The FAA becomes relevant only as it protects the enforcement of the contractual right to arbitrate. Thus, there is no conflict for preemption purposes between a state law and a federal law in this case, but rather a partial remedial conflict between a state law and a contract. *Cf. Osterneck v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 841 F.2d 508, 510 (state statute precluding enforcement of an agreement to arbitrate conflicts with FAA).[1]

Therefore, for the foregoing reasons I would affirm the district court's order enjoining the Delaware Securities Commissioner from pursuing the remedy of rescission of the claims which are subject to the arbitration agreement between Olde and the Engelhardts. I agree with the majority that the district court was not required

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[1] The agreement to arbitrate cannot usurp a state's public interest in enforcing its criminal laws for securities transactions violations or its laws enacted under its police power to protect the public interest generally. "The criminal justice system is not operated primarily for the benefit of victims, but for the benefit of society as a whole." *Kelly v. Robinson*, 479 U.S. 36, 51 (1986). Therefore, the district court was correct not to enjoin the Commissioner from seeking other penal remedies against Olde besides rescission.

to abstain from enjoining the Commissioner's pursuit of rescission.

NYGAARD, *Circuit Judge*, dissenting.

I disagree with the court's conclusion that the Federal Arbitration Act, 9 U.S.C. § 2, preempts 6 Del. Code Ann. § 7325(b) for essentially the same reasons articulated in Judge Rosenn's concurrence. There is no conflict between federal and state law because, as Judge Rosenn notes, the FAA protects the enforcement of the contractual right to arbitrate. Where there has been an allegation of securities fraud, section 7325(b) empowers the Delaware Securities Commissioner to seek rescission at his discretion and in the interest of the public; it says nothing about the validity of the arbitration agreement or the arbitrability of the dispute between Olde Discount and the Engelhardts. Since section 7325(b) does not "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration," *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 858 (1984), the FAA does not preempt the Delaware statute.

I depart from the reasoning of the concurrence, however, to the extent it concludes that the Engelhardts have the capacity to contract away under Delaware law the Commissioner's authority to institute administrative proceedings and to seek remedies against securities firms doing business in Delaware. The essence of Olde Discount's argument is that there is no distinction between the Engelhardts' civil suit in their own interest to seek a

compensatory award and the Commissioner's administrative actions in the public interest to seek appropriate equitable or punitive measures. This argument is unpersuasive in light of the statutory scheme.

The Delaware Securities Act was enacted "to prevent *the public* from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations." 6 Del. Code Ann. § 7301(b) (emphasis added). The Commissioner administers the statute and serves this policy. Among other things, he may "deny, suspend or revoke any registration if he finds that the order is in the *public interest*"; and he may in his discretion bring an action "to temporarily restrain or to enjoin the acts or practices . . . [as well as seek] such other ancillary relief as is in the public interest. . . . " *Id.* §§ 7316(a), 7320 (emphasis added). In section 7325(b), the Delaware legislature gave the Commissioner the exclusive power to bring administrative proceedings in which he may order the violator "to pay restitution and costs (or to rescind the transaction or transactions and pay costs) if the Commissioner finds it in the *public interest*. . . . " (Emphasis added.) And in section 7323(a), the legislature also gave "the person" who is a victim of securities fraud a nonexclusive, private cause of action in law or equity.

Thus, the Delaware statutory scheme makes clear that the Commissioner is not a surrogate for a plaintiff's attorney, but is a public official who administers the state's blue sky laws "in the public interest" and is endowed with broad enforcement and rulemaking powers. See *Blinder, Robinson & Co. v. Bruton*, 552 A.2d

466, 475 (Del. 1989) ("The Commissioner has discretion to impose any penalty deemed necessary to protect the public interest and further the Act's prophylactic purpose.") Although the Engelhardts' and the Commissioner's suits arise from the same transaction, their respective right or power to sue arises from two separate and distinct statutory provisions.

The arbitration agreement between the Engelhardts and Olde Discount provides that the Engelhardts must "submit any and all controversies or claims arising out of this agreement to arbitration." It also provides, "*The parties* are waiving their right to seek remedies in court, including the right to a jury trial." Under the FAA and this arbitration agreement, there is no doubt that *the Engelhardts* cannot enforce a claim for legal damages or equitable relief under section 7323(a) in a judicial forum. But that is not at issue in this appeal because nothing in the Delaware laws precludes the Engelhardts and Olde Discount from arbitrating.

Here, Olde Discount contends, and the opinion of the court agrees, that the arbitration agreement between it and the Engelhardts precludes *the Commissioner,* acting under the authority of the Delaware legislature, from seeking appropriate remedies and sanctions in the public interest if the Engelhardts have also asked for the "same" relief in their civil complaint. Thus, while this case concerns rescission as a remedy, had the Engelhardts sought injunctive relief as well as money damages in arbitration, there is no reason under the court's opinion why these private parties could not have also contracted away the Commissioner's authority under section 7320 to seek an injunction against Olde Discount.

The Commissioner cannot be bound by an agreement to which he neither agreed nor was a party. One cannot bargain away that which one does not possess; since the power to sue under section 7325(b) and seek appropriate equitable remedies on behalf of the State of Delaware and in the public interest belongs exclusively to the Commissioner, that power cannot be compromised by an agreement between private individuals. Cf. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S.Ct. 927, 939 (1983) (in a multi-party and -claim case, arbitration agreements will be enforced as to those parties and claims subject to the agreement despite piecemeal litigation in the arbitral and judicial forums). Further, the Commissioner's authority to sue and seek remedies exists independently of a plaintiff's right to sue and thus is not derivative of the Engelhardts' rights. See 6 Del. Code Ann. § 7319 ("The Commissioner in his discretion may make such public or private investigations within or outside of this State as he deems necessary. . . . "). See also *Gilmer v. Interstate/Johnson Lane Corp.*, 111 S.Ct. 1647, 1653 (1991) ("In any event, the EEOC's role in combating age discrimination is not dependent on the filing of a charge; the agency may receive information concerning alleged violations of the ADEA 'from any source,' and it has independent authority to investigate age discrimination). Cf. *Isidor Paiewonsky Assocs. v. Sharp Properties, Inc.*, No. 92-7337 (3d Cir., June 24, 1993) (a subtenant who was not a party to an arbitration agreement was bound by the conclusions of the arbitrator because the subtenant and tenant are in privity and thus the subtenant's rights are derivative of the tenant's under traditional landlord-tenant laws).

The argument that section 7325(b) is "preempted" by the FAA or that the Commission is "contractually bound" by the arbitration agreement rests on the unsound assumption that legal damages by the Engelhardts and rescission sought by the Commissioner in the public interest are in essence the same remedies. In *Porter v. Warner Holding Co.*, 328 U.S. 395, 66 S.Ct. 1086 (1946), although regulations provided that a landlord could not be required to make a tender of illegally collected rent if the suit was brought by any person who had commenced an action against the defendant under Section 205(e) of the Emergency Price Control Act of 1942, a federal agency brought suit against the landlord and sought restitution of illegally collected rent under the authority of § 205(a) of the statute. The Supreme Court considered whether a federal district court had jurisdiction, in an enforcement proceeding brought by a federal agency under § 205(a), to order restitution of illegally collected rents. The Court held that it did, and reasoned:

> It is true that § 205(e) authorizes an aggrieved purchaser or tenant to sue for damages on his own behalf. . . . To the extent that damages might properly be awarded by a court of equity in the exercise of its jurisdiction under § 205(a), § 205(e) supersedes that possibility and provides an exclusive remedy relative to damages. *It establishes the sole means whereby individuals may assert their private right to [legal] damages.* . . . Moreover, a court giving relief under § 205(e) acts as a court of law rather than as a court of equity. But with the exception of damages, § 205(e) in no way conflicts with the jurisdiction of equity courts under § 205(a) to issue whatever "other orders" may be necessary

> to vindicate the public interest, to compel compliance with the Act and to prevent and undo inflationary tendencies.
>
> *Restitution, which lies within that equitable jurisdiction, is consistent with and differs greatly from the damages and penalties which may be awarded under § 205(e).* When the Administrator seeks restitution under § 205(a) he does not request the court to award statutory damages to the purchaser or tenant or to pay to such person part of the penalties which go to the United States treasury in a suit by the Administrator under § 205(e). Rather he asks the court to act *in the public interest* by restoring the status quo and ordering the return of that which rightfully belongs to the purchaser or tenant. Such action is within the recognized power and within the highest tradition of a court of equity. Thus it is plainly unaffected by the provisions of § 205(e).

66 S.Ct. at 1090-91 (emphasis added and citations omitted). Thus, legal damages and equitable relief, such as restitution and rescission, are different forms of relief, serving different interests and arising from different powers of the court; and even if an arbitrator decides that the Engelhardts are not entitled to legal damages, that decision neither conflicts with nor precludes a court of equity from granting the remedy of rescission to the Engelhardts in the interest of the public.

The Supreme Court recognized this difference in the arbitration context. In *Gilmer*, the Supreme Court considered whether a claim under the Age Discrimination in Employment Act of 1967 (ADEA) can be subject to arbitration under the FAA. The Court held that ADEA claims

were arbitrable. The Court found unpersuasive the argument that arbitration would undermine the role of the EEOC in enforcing the ADEA. It reasoned, "An individual ADEA claimant subject to an arbitration agreement will still be free to file a charge with the EEOC, even though the claimant is not able to institute a private judicial action." 111 S.Ct. at 1653. Furthermore, "it should be remembered that arbitration agreements will not preclude the *EEOC* from bringing actions seeking class-wide and equitable relief." *Id.* at 1655 (emphasis in original). Equitable relief includes such remedies as injunction and rescission. *Porter,* 66 S.Ct. at 1090-91.

I believe that the opinion of the court unlawfully transfers the authority vested in the Commissioner to private parties. Thus, the boundaries of what the Commissioner, or any other agency with enforcement powers, can or cannot do is not defined by statute, but is limited by the agreements of private individuals. I would hold that since section 7325(b) of the Delaware Securities Act expressly provides that the Commissioner may seek appropriate equitable relief against a violator of the state's securities laws, he is not bound by a private arbitration agreement, nor need he refrain from seeking rescission in the public interest simply because a private party agreed to seek legal damages in an arbitral forum rather than a court of law. I therefore respectfully dissent.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

Filed August 5, 1993

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 92-7557

OLDE DISCOUNT CORPORATION

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT and CAROL D. ENGELHARDT,

Appellants

Appeal from the United States District Court
for the District of Delaware

(D.C. Civil No. 92-00498)

Argued June 10, 1993

Before: GREENBERG, NYGAARD, and ROSENN,
Circuit Judges

Opinion Filed July 30, 1993

ORDER AMENDING CONCURRING OPINION

It is hereby ordered that the concurring opinion of the slip opinion in the above-entitled case be and is hereby amended as follows:

Page 26, line 1 – change "the majority's" to "Judge Greenberg's";

Page 27, line 24 – change "the majority" to "Judge Greenberg,"

Page 28, line 5 – change "the majority" to "Judge Greenberg";

Page 29, lines 8-9 – change "the majority" to "Judge Greenberg."

BY THE COURT:

/s/ Max Rosenn

Circuit Judge

Dated: August 5, 1993

A True Copy:

Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 92-7557

OLDE DISCOUNT CORPORATION,

v.

W. MICHAEL TUPMAN, and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities commissioner of the State of Delaware; EUGENE H. ENGELHARDT AND CAROL D. ENGELHARDT,

W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware; EUGENE H. ENGELHARDT, CAROL D. ENGELHARDT,

Appellants

On Appeal from the United States District Court
for the District of Delaware
(D. Del. Civil No. 92-0498)

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, *Chief Judge*, and BECKER, STAPLETON, MANSMANN, GREENBERG,

HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, LEWIS, AND ROSENN, *Circuit Judges*

The petition for rehearing filed by the appellants W. Michael Tupman, Richard W. Hubbard, Eugene H. Engelhardt, and Carol D. Engelhardt in the above captioned matter having been submitted to the judges who participated in the decision of this court and to all other available circuit judges of the court in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied. Judge Nygaard would grant rehearing by the court in banc for the reasons set forth in his dissenting opinion limited to the preemption issue.

BY THE COURT:

/s/ Morton I. Greenberg
Circuit Judge

DATED: AUG 26, 1993

OLDE DISCOUNT CORPORATION,
Plaintiff,

v.

W. Michael TUPMAN, individually and as Deputy Attorney General of the State of Delaware; Richard W. Hubbard, Securities Commissioner of the State of Delaware, Eugene H. Engelhardt, and Carol D. Engelhardt, Defendants.

Civ. A. No. 92-498-SLR.

United States District Court,
D. Delaware.

Sept. 16, 1992.

James S. Green of Duane, Morris & Heckscher, Wilmington, Del., for plaintiff. Of Counsel: Robert P. Bramnik, Thomas P. Fitzgerald, and Michael I. Behn, of Altheimer & Gray, Chicago, Ill.

W. Michael Tupman, Delaware Dept. of Justice, Wilmington, Del., for defendants W. Michael Tupman and Richard W. Hubbard.

MEMORANDUM OPINION

SUE L. ROBINSON, District Judge.

I. INTRODUCTION

Before the Court is a motion for temporary restraining order, preliminary injunction and other relief filed by plaintiff OLDE Discount Corporation ("OLDE") in order to enjoin defendants from: "(1) pursuing a penal and registration revocation action against the plaintiff which will have the effect of violating plaintiff's federal right to arbitrate. . . . ; (2) pursuing an investigation of OLDE; and

(3) instigating other actions against the plaintiff in Delaware or any other state, pending a hearing and determination on the issuance of a preliminary injunction." (Docket item, "D.I.", 4) Defendants Richard W. Hubbard and W. Michael Tupman (hereinafter "the State defendants")[1], the Securities Commissioner of the State of Delaware and the Deputy Attorney General representing such, respectively, have responded and oral argument was heard on August 27, 1992. Supplemental responses have been received. (D.I. 19, 28)

II. JURISDICTION

Jurisdiction is grounded on plaintiff's claim regarding the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-10, and 28 U.S.C. § 1331.

Venue is proper in this District under 28 U.S.C. § 1391(b) because all defendants reside in this District and because the claims asserted by plaintiff arose in this District.

III. FINDINGS OF FACT

For purposes of this proceeding, the material facts are undisputed:

1. Plaintiff OLDE is a securities firm with its principal place of business located at 751 Griswold Street, Detroit, Michigan 48226. OLDE also has a branch office

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[1] Because the relief sought is directed at the State defendants, defendants Eugene H. and Carol D. Engelhardt have not participated in these proceedings.

located at 208 West Tenth Street, Wilmington, Delaware 19801. (D.I. 12, Ex. 1, ¶ 12)

2. OLDE is and has been registered as a broker-dealer in Delaware since October 6, 1981. Although OLDE is primarily engaged in the discount brokerage business, it does make a market in certain securities, which its agents recommend to customers. In the spring of 1990, one of the stocks was Second National Federal Savings Bank ("SNFS"), a savings and loan association with branches in Pennsylvania, Maryland, Delaware, Virginia, and the District of Columbia. (D.I. 14, Ex. 1, ¶ 15)

3. The Division of Securities of the State of Delaware is a unit within the Department of Justice directed by the Securities Commissioner under the auspices of the Attorney General pursuant to the Delaware Securities Act, 6 Del.C. § 7301 *et seq.*

4. In 1983, defendants Eugene H. and Carol D. Engelhardt opened a joint account with OLDE in Michigan, where they were then residing. When they moved to Delaware in 1986, they transferred their account to OLDE's Wilmington office. In the spring of 1990, their account was assigned to Michael R. Donohoe, the only securities agent employed in OLDE's Wilmington branch. (D.I. 12, Ex. 1, ¶ 22)

5. The Engelhardt's account with OLDE was governed by the terms of an Investors Account Agreement between OLDE and the defendants Engelhardt. The Investors Account Agreement in effect during the period relevant to this proceeding was signed by the defendants Engelhardt on May 25, 1990. According to their Customer

Preference Profile, the defendants Engelhardt had substantial investment experience, having invested in stocks for approximately fifteen years, making an average of three to five trades per year, and trading an average of five to ten thousand shares per transaction. In describing their investment objects, the defendants Engelhardt chose the following adjectives: "aggressive", "growth", "speculation". (D.I. 6, Ex. A)

6. The Investors Account Agreement entered between OLDE and the defendants Engelhardt included a "Predispute Arbitration Clause". The inclusion of the Predispute Arbitration Clause was disclosed in bold face and in large type directly above the defendants' signatures. (D.I. 6, Ex. A)

7. The Predispute Arbitration Clause itself was more specifically spelled out in the terms and conditions portion of the agreement, clauses 17 and 18, in bold type. In relevant part, the Predispute Arbitration Clause provides that the Engelhardts "agree to submit any and all controversies or claims arising out of this agreement to arbitration" according to the procedures of the New York Stock Exchange, Inc. or the National Association of Security Dealers, Inc. (D.I. 6, Ex. A)

8. In May and June 1990, the defendants Engelhardt purchased a total of ten thousand shares of the common stock of SNFS. The total purchase price of the ten thousand shares of SNFS stock was $52,875.00. During the course of the next several months, the market price of SNFS stock declined, causing a parallel decline in the market value of the defendants Engelhardts' SNFS account. (D.I. 1, ¶ 13)

9. In July or August 1990, the defendants Engelhardt telephoned OLDE in Michigan to express their dissatisfaction with their SNFS stock purchase, given the drop in price. The defendants Engelhardt were informed that there was no basis for their complaint, that their SNFS stock purchases were not inappropriate. (D.I. 1, ¶ 15)

10. According to the record, the defendants Engelhardt were advised at that time that they should submit a written complaint to OLDE regarding the circumstances of their claim if they wished to initiate a complaint and/or a fuller review. (D.I. 1, ¶ 15) No written complaint was ever submitted, although the Investors Account Agreement, clause 12, expressly requires investors to object, in writing, within ten days regarding any transactions in their account which are in dispute. (D.I. 1, ¶ 18; D.I. 6, Ex. A)

11. On September 6, 1990, the defendants Engelhardt transferred their SNFS stock out of OLDE. The market value of their SNFS stock at the time of the transfer was approximately $32,500.00, a decline of approximately $20,375.00 from their initial investment. (D.I. 1, ¶ 17)

12. In July 1991, the Division of Securities of the State of Delaware received a complaint from the defendants Engelhardt against OLDE and its agent (by now a former agent), Michael Donohoe, with regard to the purchase of the SNFS stock in May and June of 1990. (D.I. 6, Ex. C; D.I. 12, ¶ 2).

13. By letter dated July 31, 1991, a securities investigator for the Delaware Department of Justice advised

OLDE of the Engelhardts' complaint. The securities investigator related that "[t]he Engelhardts allege that the solicitation to purchase [the SNFS stock] involved omission of material facts (including the risk factor) and high pressure selling techniques. They further allege that Mr. Donohoe marked at least one purchase 'unsolicited'. Finally, they allege that this security was unsuitable for persons in their circumstances." The securities investigator requested that OLDE respond to these allegations by August 26, 1991. (D.I. 6, Ex. C; D.I. 12, ¶ 2) OLDE responded to this and subsequent requests for documents and information. (D.I. 6, Ex. E; D.I. 12, ¶ 2-4)

14. By late May 1992, the Division of Securities had completed its investigation of the Engelhardts' complaint and on June 5, 1992, defendant Tupman sent to OLDE a draft "Notice of Intent to Suspend or Revoke Broker-Dealer Registration", alleging various violations of the Delaware Securities Act, 6 Del.C. §§ 7301 *et seq.* (D.I. 12, ¶ 5) In said Notice, defendant Tupman stated that it was in the public interest that: 1) the broker-dealer registration of OLDE be suspended or revoked; 2) Donohoe be permanently barred from engaging in the securities business in Delaware; 3) OLDE rescind the three sales of SNFS stock to the defendants Engelhardt, and pay the Engelhardts back their purchase price of $52,875.00; and 4) OLDE be fined $10,000.00 for each and every violation of the Act, and that OLDE pay all of the costs incurred by the Division of Securities in connection with the investigation and prosecution of the case. (D.I. 6, Ex. F)

15. By letter dated June 25, 1992, OLDE asserted that the proposed administrative proceeding against OLDE for Donohoe's alleged sales practice abuses was

not warranted. OLDE also offered to settle the Engelhardts' claim concerning their SNFS stock purchases by offering $20,000.00 as compensation for all of the losses which were allegedly caused by Donohoe's conduct. In the alternative, OLDE offered to "pay all filing and form fees for the Engelhardts' claim to be heard and decided by an arbitration panel before the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc. or the American Arbitration Association." (D.I. 6, Ex. G)

16. By letter dated July 6, 1992, defendant Tupman responded:

> In considering your offer of settlement, I assume that the $20,000.00 figure represents the difference between the price paid by the Engelhardts for their SNFS stock, and the current market value. Given the allegations of unsuitability, I think it much more appropriate for there to be a rescission of the trades, with your firm receiving the stock back and the Engelhardts their purchase price ($52,875.00).
>
> In addition, because of the seriousness of the allegations, and the State's preparedness to prosecute, the public interest would require a substantial contribution to the Investor Protection Fund, as well as written undertakings regarding compliance procedures in your Wilmington branch office.
>
> I do not intend to continue any further written dialogue on the allegations in the draft Notice. I think you have fully set forth your position in your last letter, and I am not amendable to any continued "back and forth" responses. Instead, I suggest you call me later this week (and in no

> event later than noon on Friday, July 10), to discuss the terms of settlement. Otherwise, the Securities Division is prepared to submit the charges to the Commissioner for his approval on July 13.

(D.I. 6, Ex. H)

17. At an August 5, 1992 settlement meeting attended by defendant Tupman and representatives of plaintiff OLDE, defendant Tupman once again rejected OLDE's offer of restitution to the Engelhardts in the amount of $20,375.00 and instead demanded rescission in the amount of $52,875.00, on the grounds that rescission would be more beneficial and fair to the Engelhardts. Defendant Tupman also stated that the Engelhardts refused to arbitrate their civil claims; rather, the Engelhardts had selected the Delaware Securities Commissioner's Office to pursue their claim. (D.I. 6, Ex. I)

18. After the August 5, 1992 meeting with defendant Tupman, OLDE gave written notice of its demand that the Engelhardts arbitrate their civil claim against OLDE concerning their SNFS stock purchases pursuant to their arbitration agreement and the Federal Arbitration Act, 9 U.S.C. §§ 1 *et seq.* The August 5, 1992 notice stated as follows:

> We have been informed by Delaware Deputy Attorney General, W. Michael Tupman, that you have complained to him about the purchase of SNFS stock through OLDE Discount. He further advises that you believe that you have a remedy under the restitution provision set forth in section 7325(b) of the Delaware Code. We disagree.

> You have agreed with OLDE Discount to resolve any and all disputes by arbitration before either the New York Stock Exchange ("NYSE") or the National Association of Security Dealers, Inc. ("NASD"). You further have agreed to make an election within five days of written demand of such election. Please consider this letter our written demand that you make such election.

(D.I. 6, Ex. K)

19. According to his affidavit, defendant Tupman met with the defendants Engelhardt on August 10, 1992 to inform them that plaintiff OLDE had made a settlement offer, to wit, to pay $15,000.00 to the Delaware Investors Protection Fund, in lieu of a fine, and to pay $20,375.00 in full restitution to the Engelhardts for the depreciation in value of their SNFS stock during the entire period of time that the stock was held in their OLDE account. Both defendants Engelhardt "emphatically agreed that they wanted the State to go forward with its case." (D.I. 12, ¶ 11)

20. Also on August 10, 1992, defendant Tupman represented in a letter to OLDE the following:

> [I]t has come to our attention that by letter dated August 5, 1992 . . . , you tried to pressure the Engelhardts into an NASD arbitration, even though we had discussed that legal issue at our meeting the same day, and the State had disagreed with your legal position. I find this further evidence of your bad faith, and therefore terminate settlement negotiations. Your last offer is rejected.
>
> Enclosed are written interrogatories served pursuant to Section 7319 of the Delaware Securities

> Act. An officer, director, or duly authorized agent of OLDE must answer those interrogatories, under oath, and return them to me no later than seven business days after the date of this letter. In addition, with regard to each individual identified in your response to Interrogatory No. 1, we ask that you produce his or her new account form and customer preference profile, and with regard to each transaction identified in your response to Interrogatory No. 2, we ask that you produce the confirmation of purchase. Further, we ask that you produce copies of any letters of complaint, and any response your made, from any Delaware residents with regard to those transactions. You have until the close of business on August 24, 1992 to produce that documents.

(D.I. 6, Ex. M)

21. A Notice of Intent to Suspend or Revoke Broker-Dealer Registration was filed by the Division of Securities on August 17, 1992. Defendant Hubbard, the Securities Commissioner, also signed an order of that same date giving OLDE thirty days to request a hearing on the matter. (D.I. 12, Ex. 1)

22. On August 17, 1992, the Department of Justice issued a press release concerning the Notice of Intent against OLDE. An article reporting the Notice appeared the next day in the News Journal. (D.I. 6, Ex. N)

23. On August 19, 1992, OLDE provided timely responses to defendant Tupman's interrogatories. (D.I. 1, ¶ 39)

24. Plaintiff filed its motion for temporary restraining order, preliminary injunction and other relief on

August 25, 1992, alleging, *inter alia*, that: 1) application and enforcement of § 7325(b) of the Delaware Securities Act, 6 Del.C. § 7325(b), is unconstitutional under Article VI, clause 2 of the United States Constitution (the "Supremacy Clause"); 2) the application of 6 Del.C. § 7325(b), as amended, to the actions of OLDE in 1990 constitutes the imposition of an *ex post facto* penalty in violation of the Due Process Clause of the Fourteenth Amendment of the Constitution of the United States; 3) defendants Tupman and Hubbard have acted under color of state law to deprive the plaintiff of its rights under the Federal Arbitration Act and under the Due Process Clause in violation of 42 U.S.C. § 1983; and 4) defendant Tupman has committed willful acts in the use of process not proper in the regular conduct of these administrative proceedings. (D.I. 1)

IV. CONCLUSIONS OF LAW

The standard for obtaining a temporary restraining order is the same as the standard for a preliminary injunction. Fed. R.Civ.P. 65(b); *Tootsie Roll Industries, Inc. v. Sathers, Inc.*, 666 F.Supp. 655, 658 (D.Del.1987). It is beyond dispute that "the grant of injunctive relief is an 'extraordinary remedy, which should be granted only in limited circumstances.' " *Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d 797, 800 (3d Cir.1989), *citing Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d 100, 102 (3d Cir.1988). Thus, in ruling on a motion for a preliminary injunction, this Court must consider:

> (1) the likelihood that the [movant] will prevail on the merits at final hearing; (2) the extent to which the [movant] is irreparably harmed by the

> conduct complained of; (3) the extent to which the [nonmoving party] will suffer irreparable harm if the preliminary injunction is issued; and (4) the public interest.

Opticians Ass'n of America v. Independent Opticians of America, 920 F.2d 187, 191-92 (3d Cir.1990). As recently reaffirmed by the Third Circuit, an

> injunction should issue only if the [movant] produces evidence sufficient to convince the . . . [C]ourt that all four factors favor preliminary relief.

Merchants & Evans, Inc. v. Roosevelt Bldg. Products, Co., 963 F.2d 628, 632-633 (3d Cir.1992). *See also Instant Air Freight Co. v. C.F. Air Freight, Inc.*, 882 F.2d at 800, *quoting In re Arthur Treachers Franchisee Litigation*, 689 F.2d 1137, 1143 (3d Cir.1982).

A. *Reasonable Probability of Success on the Merits*

1. Pre-emption

Plaintiff's primary argument in support of its request for injunctive relief is that § 7325(b) of the Delaware Securities Act, as amended, 6 Del.C. § 7325(b), is unconstitutional because it directly conflicts with the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-10. The primary substantive provision of the FAA states that

> [a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such grounds as

> exists at law or in equity for the revocation of any contract.

9 U.S.C. § 2. As explained by the Supreme Court in *Perry v. Thomas*, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed 2d 426 (1987),

> "Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 941, 74 L.Ed.2d 765 (1983). Enacted pursuant to the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3, this body of substantive law is enforceable in both state and federal courts. *Southland Corp. v. Keating*, 465 U.S. 1, 11-12, 104 S.Ct. 852, 858-859, 79 L.Ed.2d 1 (1984). . . . As we stated in *Keating*, "[i]n enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contacting parties agreed to resolve by arbitration." *Id.*, at 10, 104 S.Ct. at 858. "Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements." *Id.*, at 16, 104 S.Ct. at 861 (footnote omitted). Section 2, therefore, embodies a clear federal policy of requiring arbitration unless the agreement to arbitrate is not part of a contract evidencing interstate commerce or is revocable "upon such grounds as exist at law or in equity of the revocation of any contact." 9 U.S.C. § 2. "We see nothing in the

> Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Keating, supra,* at 11, 104 S.Ct., 858.

Id. 482, U.S. at 489, 107 S.Ct. at 2525.

In the case of *Perry v. Thomas,* Thomas sued his former employer, Kidder Peabody & Co., for breach of contract, conversion, civil conspiracy to commit conversion, and breach of fiduciary duty, for which he sought compensatory and punitive damages. Thomas refused to submit the dispute to arbitration based on § 229 of the California Labor Code, which authorized Thomas to maintain an action for wages. The Supreme Court, in holding that the Supremacy Clause and § 2 of the FAA pre-empted the state statute, concluded:

> [T]he present appeal addresses the pre-emptive effect of the Federal Arbitration Act, a statute that embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause. Its general applicability reflects that "[t]he preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered. . . . " [*Dean Witter Reynolds Inc. v. Bird,* 470 U.S. 213, 221, 105 S.Ct. 1238, 1242, 84 L.Ed.2d 158 (1985)]. We have accordingly held that these agreements must be "rigorously enforce[d]." *Ibid.; see Shearson/American Express Inc. v. McMahon,* 482 U.S. 220, 226 [107 S.Ct. 2332, 2337, 96 L.Ed.2d 185] . . . (1987); *Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth, Inc.,* 473 U.S. 614, 625-626 [105 S.Ct. 3346, 3353-3354, 87 L.Ed.2d 444] . . . (1985). This clear

> federal policy places § 2 of the Act in unmistakable conflict with California's § 229 requirement that litigants be provided a judicial forum for resolving wage disputes. Therefore, under the Supremacy Clause, the state statute must give way.

482 U.S. at 490, 107 S.Ct. at 2526. *Accord, Securities Industry Asso. v. Connolly,* 883 F.2d 1114 (1st Cir.1989), *cert. denied,* 495 U.S. 956, 110 S.Ct. 2559, 109 L.Ed.2d 742 (1990) (a Massachusetts state regulation which: (1) barred firms from requiring individuals to enter pre-dispute arbitration agreements as a nonnegotiable condition precedent to account relationships; (2) ordered the prohibition brought "conspicuously" to the attention of prospective customers; and (3) demanded full written disclosure of "the legal effect of the pre-dispute arbitration contract or clause", pre-empted by the FAA); *Osterneck v. Merrill Lynch, Pierce, Fenner & Smith,* 841 F.2d 508 (3d Cir.1988) (provision of the Pennsylvania Securities Act, identical to § 410(g) of the Uniform Securities Act and precluding enforcement of an agreement to arbitrate, pre-empted by the FAA).

Not only does the FAA pre-empt state statutes which provide a judicial forum for resolving disputes, "[i]t is by now clear that statutory claims may be the subject of an arbitration agreement, enforceable pursuant to the FAA." *Gilmer v. Interstate/Johnson Lane Corp.,* ___ U.S. ___, ___, 111 S.Ct. 1647, 1652, 114 L.Ed.2d 26 (1991). The issue before the Court in *Gilmer* was whether a claim under the Age Discrimination and Employment Act of 1967 ("ADEA"), could be subjected to compulsory arbitration

pursuant to an arbitration agreement in a securities registration application. The Court, recognizing that "the ADEA is designed not only to address individual grievances, but also to further important social policies", found no

> inherent inconsistency between those [social] policies . . . and enforcing agreements to arbitrate age discrimination claims. It is true that arbitration focuses on specific disputes between the parties involved. The same can be said, however, of judicial resolution of claims. Both of these dispute resolution mechanisms nevertheless also can further broader social purposes. The Sherman Act, the Securities Exchange Act of 1934, RICO, and the Securities Act of 1933 all are designed to advance important public policies, but, as noted above, claims under those statutes are appropriate for arbitration. " [S]o long as the prospective litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum, the statute will continue to serve both its remedial and deterrent function." *Mitsubishi, supra,* 473 U.S., at 637 [105 S.Ct. at 3359]. . . .

___ U.S. at ___, 111 S.Ct. at 1653. Noting the "liberal federal policy favoring arbitration agreements", the Court concluded that Gilmer's ADEA claim was subject to compulsory arbitration.

State defendants argue that the Delaware Securities Act does not directly conflict with the FAA in that no provision specifically precludes plaintiff from pursuing its right to arbitrate. And, indeed, no provision of the Delaware Securities Act even mentions arbitration. There is no question, however, that the regulatory scheme as

currently drafted contemplates administrative proceedings which effectively eliminate a party's right to an arbitral forum.

Under the Delaware Securities Act, 6 Del.C. §§ 7301 *et seq.*, the Securities Commissioner is authorized to suspend or revoke the registration of a broker-dealer or agent, if he determines that such person is subject to one of the disqualifying factors stated in that section and that such action is in the public interest. 6 Del.C.§ 7316(a). Subsection (g) of § 7316 also authorizes the Commissioner, "upon notice and hearing", to fine any broker-dealer, investment advisor or agent in an amount not to exceed $10,000.00 for each and every violation of the chapter, plus the cost of investigation and prosecution.

In addition to the public enforcement authority vested in the Securities Commissioner under § 7316, § 7323 provides as well for private causes of action for rescission brought by injured investors. More specifically, § 7323 provides in relevant part that "[a]ny person who . . . sells . . . a security by means of any untrue statement of a material fact or any omission to state a material fact . . . is liable to the person buying . . . the security . . . , who may sue either at law or in equity to recover the consideration paid for the security. . . . " Subsection (g) of § 7323, modeled after § 410(g) of the Uniform Securities Act, provides:

> (g) Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.

This subsection is identical to the Pennsylvania statute reviewed by the Third Circuit in *Osterneck*, 841 F.2d at 510, which subsection was found to be pre-empted by the FAA.

Although the Delaware Securities Act provides that any person aggrieved by an order of the Securities Commissioner may obtain a review of the order in the Court of Chancery, the commencement of the judicial review proceedings does not, unless specifically ordered by the Court of Chancery, operate as a stay of the Commissioner's order. 6 Del.C § 7324.

Section 7325(b) of the Delaware Securities Act, the statutory provision primarily at issue, was amended in July 1990 to provide:

> (b) The Commissioner may make, amend and rescind rules, regulations, forms and orders to carry out and define the provisions of this chapter. Such orders may provide for fines, assessment of costs, restitution to investors, conditional or probationary registration, centaur [sic] or reprimand, special reporting requirements, or other provisions which the Commissioner determines to be in the public interest.

Subsequently, in June 1991, subsection (b) was amended once again to provide:

> Any person, whether registered or not, who willfully violates any provision of this chapter, or who aides [sic] and abets any person who willfully violates any provision of this chapter, may be fined in accordance with subsection 7316(g) and order [sic] to pay restitution and costs (*or to rescind the transaction or transactions and pay costs*) if the Commissioner finds it in the

> public interest, any may be criminally prosecuted under § 7322.[2]

Although there apparently is no caselaw directly on point involving state administrative proceedings that impede a party's right to enforce a predispute arbitration agreement, the Securities Commissioner cannot use his authority under 6 Del.C § 7325(b) as both a sword – to enforce under § 7325(b) investors' personal rights to rescission provided under § 7325(a) – and a shield – to insulate the investors from a contracted to arbitral forum by insisting on the primacy of the State's administrative forum – without running afoul of the Supremacy Clause of the Constitution.[3] There is no contention that the arbitration agreement at issue is not enforceable under the FAA. Neither is there a contention at bar that the defendants Engelhardt may not effectively vindicate their statutory cause of action in the arbitral forum.

Given the clear Congressional intent "to provide for the [rigorous] enforcement of arbitration agreements within the full reach of the Commerce Clause", *Perry v. Thomas*,

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[2] Although the State defendants maintain that the Delaware Securities Act is "modeled on the Uniform Securities Act" (D.I. 10 at 21), the Court can find no counterpart in the Uniform Act to § 7325(b) as amended.

[3] The Supremacy Clause provides that:

> This Constitution, and the Law of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. Const., Art. VI, cl. 2.

482 U.S. at 490, 107 S.Ct. at 2526, as given effect by the Supreme Court's interpretation of the FAA, the Court concludes that the FAA serves to withdraw the power of the states not only to require a judicial forum for the resolution of claims, but to require an administrative forum as well. In sum, then, the FAA pre-empts § 7325(b) insofar as that statute allows the Securities Commissioner to order rescission on behalf of individual investors who have signed predispute arbitration agreements.

2. Primary Jurisdiction

The State defendants argue that the FAA does not pre-empt the administrative proceedings at bar by virtue of the doctrines of primary jurisdiction or, alternatively, the exhaustion of administrative remedies. As explained by the United States Supreme Court in *United States v. Western Pacific Railroad Co.*, 352 U.S. 59, 77 S.Ct. 161, 1 L.Ed.2d 126 (1956),

> [t]he doctrine of primary jurisdiction, like the rule requiring exhaustion of administrative remedies, is concerned with promoting proper relationships between the courts and administrative agencies charged with particular regulatory duties. "Exhaustion" applies where a claim is cognizable in the first instance by the administrative agency alone; judicial interference is withheld until the administrative process has run its course. "Primary jurisdiction," on the other hand, applies where a claim is originally cognizable in the courts, and comes into play whenever enforcement of the claim requires the resolution of issues which, under a regulatory scheme, have been placed within the special

> competence of an administrative body; in such a case the judicial process is suspended pending referral of such issues to the administrative body for its views.

Id. at 63-4, 77 S.Ct. at 165.

Applying this lucid explanation to the facts at bar, the Court concludes, first, that the doctrine of primary jurisdiction does not apply. As further illustrated by the Supreme Court in *United States v. Western Pacific Railroad Co.*, "in cases raising issues of fact not within the conventional experience of judges or cases requiring the exercise of administrative discretion, agencies created by Congress for regulating the subject matter should not be passed over." 352 U.S. at 64, 77 S.Ct. at 165. Thus, in that case, the Court concluded that

> where the question is simply one of construction [of a tariff] the courts may pass on it as an issue "solely of law." But where words in a tariff are used in a peculiar or technical sense, and where extrinsic evidence is necessary to determine their meaning or proper application, so that "the enquiry is essentially one of fact and of discretion in technical matters," then the issue of tariff application must first go to the [Interstate Commerce] Commission. The reason is plainly set forth: such a "determination is reached ordinarily upon voluminous and conflicting evidence, for the adequate appreciation of which acquaintance with many intricate facts of transportation is indispensable; and such acquaintance is commonly to be found only in a body of experts."

352 U.S. at 65-66, 77 S.Ct. at 166 (citations omitted). Unlike the interpretation of a tariff, which can involve

complex and technical cost-allocation and accounting problems, enforcement of the Engelhardts' claim does not require the resolution of any issue "placed within the special competence of" the Delaware Securities Commissioner. Indeed, the statutory scheme contemplates that such claims are appropriately resolved in a judicial forum at the investors' discretion; such claims are within the conventional experience of federal judges.

3. Exhaustion of Administrative Remedies

Nor does the doctrine of exhaustion of administrative remedies apply, since the claim at issue, i.e., the Engelhardts' claim for rescission, is not cognizable in the first instance by an administrative agency *alone*. Although by amending § 7325(b) and giving to the Securities Commissioner the authority to order rescission, private litigants (like the defendants Engelhardt) may no longer need to sue in law or in equity for rescission under § 7323(a), the Delaware Securities Act still gives private litigants that option and still specifically provides that "[t]he rights and remedies provided by this chapter are *in addition to* any other rights or remedies that may exist at law or in equity." 6 Del.C. § 7323(h) (emphasis added). Thus, unlike the "comprehensive system of review" established by the National Association of Securities Dealers, Inc. and the Securities and Exchange Commission, *see First Jersey Securities, Inc. v. Bergen*, 605 F.2d 690, 695 (3d Cir.1979), *cert. denied*, 444 U.S. 1074, 100 S.Ct. 1020, 62 L.Ed.2d 756 (1980), the statutory review procedure in question does not establish original and/or exclusive jurisdiction in the administrative proceeding.

Even if the exhaustion doctrine would normally apply, the Third Circuit has "recognized two situations in which the exhaustion requirement will not be adhered to: (1) when the administrative procedure is clearly shown to be inadequate to prevent irreparable injury; or (2) when there is a clear and unambiguous statutory or constitutional violation." *Id.* at 696. Plaintiff asserts that both exceptions apply to the facts at bar by virtue of the preemption of the FAA. The Court agrees.

If the administrative process vis.a.vis the State's rescission action under 6 Del.C. § 7325(b) is allowed to go forward, plaintiff's right to enforce the arbitration agreement entered into between it and the Engelhardts is rendered a nullity, regardless of the substantive result of the administrative proceeding. The loss of the federal substantive right to an arbitral forum is distinguishable from the business losses claimed in *First Jersey Securities, Inc. v. Bergen*, 605 F.2d at 696. Concomitantly, the Commissioner's usurpation of the parties' contractual obligation to arbitrate constitutes a clear and unambiguous violation of the Supremacy Clause as interpreted by the Supreme Court, as discussed above.

4. Abstention

In their supplemental submission (D.I. 19), the State defendants assert that the abstention doctrine of *Younger v. Harris*, 401 U.S. 37, 91 S.Ct. 746, 27 L.Ed.2d 669 (1971), is applicable to the facts at bar. In *Younger v. Harris*, the Supreme Court held that a federal court should not enjoin a pending state criminal proceeding except in the very

unusual situation that an injunction is necessary to prevent great and immediate irreparable injury. The Supreme Court has since applied the *Younger* principles to "state administrative proceedings in which important state interests are vindicated, so long as in the course of those proceedings the federal plaintiff would have a full and fair opportunity to litigate his constitutional claims." *Ohio Civil Rights Commissioner v. Dayton Christian Schools, Inc.*, 477 U.S. 619, 627, 106 S.Ct. 2718, 2722-23, 91 L.Ed.2d 512 (1986). In that case, the administrative proceedings at issue were instituted by the Ohio Civil Rights Commission against a school which had terminated an individual's employment. The employee claimed her termination constituted sex discrimination; the school claimed that any investigation of the school's hiring process or any imposition of sanctions for the school's termination decisions would violate the Religion Clauses of the First Amendment, since the termination was based on the employee's failure to comply with an internal dispute resolution mechanism (the "biblical chain of command"). The Court held that: 1) the elimination of prohibited sex discrimination is a sufficiently important state interest to bring the case within the ambit of the *Younger* doctrine; and 2) the school will receive an adequate opportunity to raise its constitutional claims, if not in the administrative proceeding, then in the state courts' judicial review of the administrative proceeding.

Assuming for purposes of this proceeding that the Securities Commissioner's decision to enforce private, as well as public, interests is "a sufficiently important state interest to bring the case within the ambit of the *Younger* doctrine", nevertheless the question remains whether

plaintiff will receive "a full and fair opportunity to litigate [its] constitutional claim[s]" within the state regulatory scheme. To the extent the claims have relevance given the Court's decision on pre-emption, the state regulatory scheme (which provides for judicial review) affords plaintiff an opportunity to raise its claims based upon the Due Process Clause of the Fourteenth Amendment (*ex post facto* penalties and abuse of process) and 42 U.S.C. § 1983.

Such is not the case with respect to plaintiff's pre-emption claim. Under the auspices of the FAA, plaintiff is guaranteed in the first instance an arbitral forum in which to resolve the Engelhardts' dispute. Any other forum, whether administrative or judicial, will deprive plaintiff of its federal substantive rights under the FAA, indeed, of its opportunity to even raise its constitutional claim under the FAA. Consequently, the *Younger* doctrine is not applicable to plaintiff's pre-emption claim under the FAA.

B. *Irreparable Harm*

As indicated above, the Court has concluded that plaintiff has demonstrated a reasonable probability of success on the merits on its claim that it will be deprived of its constitutionally protected federal right to arbitrate its civil dispute with the defendants Engelhardt should the administrative action for rescission be allowed to proceed. Likewise, the Court concludes that the loss of its federal substantive right to arbitrate, should injunctive relief be denied, constitutes irreparable harm clearly distinguishable from purely economic losses. *See, Alascom,*

Inc. v. ITT North Electric Co., 727 F.2d 1419, 1422 (9th Cir.1984) (if a party "must undergo the expense and delay of a trial before being able to appeal, the advantages of arbitration – speed and economy – are lost forever. We find this consequence 'serious, perhaps irreparable'."); *Opticians Ass'n of America*, 920 F.2d at 195 (irreparable harm must be "of a peculiar nature, so that compensation and money alone cannot atone for it."); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*, 756 F.2d 1048, 1055 (4th Cir.1985).

C. *Balance of Hardships*

In weighing the possibility of harm to other interested parties from the granting of the injunction and the public interest, *Opticians Ass'n of America*, 920 F.2d at 196, several factors support the Court's conclusion that the form and magnitude of the relief contemplated by the Court are justified under the Third Circuit's preliminary injunction standards. First, the Court is granting preliminary injunction relief only with respect to the State's ability to pursue rescission actions under 6 Del.C. § 7325(b) on behalf of private investors who have entered predispute arbitration agreements enforceable under the FAA. The State is not prevented from enforcing the public's interests through actions authorized under 6 Del.C. § 7316.

Moreover, the defendants Engelhardt are not harmed or disadvantaged in any way by the entry of such an injunction. The defendants Engelhardt are free to exercise their right to have their claim heard and decided in arbitration, consistent with their arbitration agreement

with plaintiff and in accordance with the FAA. The effect of the injunction, therefore, will be to leave the parties in the position that they bargained for, with an arbitral forum as plaintiff has demanded. Finally, issuance of the injunction will advance all the strong federal purposes inherent in the FAA, such as allowing the parties "to avoid the costliness and delays of litigation." *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11, 94 S.Ct. 2449, 2453, 41 L.Ed.2d 270 (1974).

D. *Bond*

The relief requested "raises no risk of monetary harm to the defendants" and, thus, a bond is unwarranted. *Hoxworth v. Blinder, Robinson & Co., Inc.*, 903 F.2d 186, 210 (3d Cir.1990); *Frank's GMC Truck Center, Inc. v. General Motors Corp.*, 847 F.2d at 103.

V. CONCLUSION

For the reasons stated, the Court concludes that plaintiff has satisfied the standard for obtaining a preliminary injunction and, therefore, plaintiff's request for injunctive relief is granted with respect to the Securities Commissioner's authority to pursue a rescission action under 6 Del.C. § 7325(b) on behalf of the defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. § 2. The remainder of plaintiff's request for injunctive relief is denied.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

OLDE DISCOUNT CORPORATION, Plaintiff, v. W. MICHAEL TUPMAN, individually and as Deputy Attorney General of the State of Delaware; RICHARD W. HUBBARD, Securities Commissioner of the State of Delaware, EUGENE H. ENGELHARDT, and CAROL D. ENGELHARDT, Defendants.	)	Civil Action No. 92-498-SLR

ORDER

At Wilmington this 16th day of September, 1992, consistent with the Memorandum Opinion issued this same date;

IT IS ORDERED that plaintiff's motion for preliminary injunction (D.I. 4) is granted with respect to the Securities Commissioner's authority to pursue a rescission action under 6 Del. C. §7325(b) on behalf of the defendants Engelhardt, individual investors who are parties to a predispute arbitration agreement with plaintiff, which agreement is enforceable under the Federal Arbitration Act, 9 U.S.C. §2. The remainder of plaintiff's motion for injunctive relief is denied.

/s/ Sue L. Robinson
United States District Judge

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

IN THE MATTER OF:	)	
	)	
OLDE DISCOUNT CORP. and MICHAEL R. DONOHOE,	)	Case No. 91-07-01
	)	
Respondents.	)	

NOTICE OF INTENT TO SUSPEND OR
REVOKE BROKER-DEALER REGISTRATION

1. The Division of Securities ("Division") is a unit within the Department of Justice directed by the Securities Commissioner ("Commissioner") under the auspices of the Attorney General pursuant to the Delaware Securities Act ("Act"), Chapter 73 of Title 6 of the *Delaware Code*.

2. The Commissioner is charged under 6 *Del. C.* Section 7325 with enforcement of provisions of the Act.

3. Section 7316 of the Act authorizes the Commissioner to suspend or revoke the registration of a broker-dealer or agent, or any partner, officer, or director of a broker-dealer, or any person directly or indirectly controlling the broker-dealer or agent, if he determines that such person(s) are subject to one of the disqualifying factors stated in that section and that such action is in the public interest.

4. Section 7316(a)(2) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a person who has willfully violated or willfully failed to comply with any provision of the Act.

5. Section 7303(2) of the Act provides that it is unlawful for any person, in connection with the offer, sale, or purchase of any security, directly or indirectly, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

6. Section 7316(a)(7) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a broker-dealer or agent who has engaged in dishonest or unethical practices within or outside Delaware.

7. Section 7316(a)(10) of the Act authorizes the Commissioner to deny or suspend or revoke the registration of a broker-dealer that has failed reasonably to supervise its agent.

8. Under Section 7316(c), the Commissioner may summarily suspend the registration of a broker-dealer or agent pending final determination of any proceeding under that section of the Act.

9. Section 7316(c) provides that a registrant whose registration has been suspended or may be suspended is entitled to a hearing if a written request is received by the Commissioner. That section also provides that if no hearing is requested, an order of suspension will remain in effect until it is modified or vacated by the Commissioner.

10. Section 7316(g) authorizes the Commissioner to fine any broker-dealer or agent in an amount not to exceed $10,000 for each and every violation of the Act, and to assess the costs of investigation and prosecution.

11. Section 7325(b) of the Act authorizes the Commissioner to rescind a securities transaction or transactions.

Notice of Allegations

The Respondents

12. Respondent OLDE DISCOUNT CORP. ("Olde Discount"), CRD # 5979, is a securities firm with its principal place of business located at 751 Griswold Street, Detroit, Michigan 48226. Olde Discount also has a branch office located at 208 West 10th Street, Wilmington, Delaware 19801. Olde Discount is and has been registered as a broker-dealer in Delaware since October 6, 1981.

13. Respondent MICHAEL R. DONOHOE ("Donohoe"), CRD # 1085905, was, at all times relevant to the allegations in this Notice, a securities agent employed by Olde Discount in its Wilmington branch office. Donohoe's agent registration in Delaware was termed on October 19, 1990, at approximately the same time that he was terminated by Olde Discount for willful misconduct.

14. Donohoe irrevocably appointed the Commissioner as his agent for service of process with respect to any legal proceedings arising out of or in connection with the sale of securities in Delaware, pursuant to Section 7327 of the Act.

The Security

15. Although Olde Discount is primarily engaged in the discount brokerage business, it does make a market in certain securities (known in-house as "Special Venture

Stocks"), which its agents recommend to customers. One of those stocks is Second National Federal Savings Bank ("SNFS"), a savings and loan association with branches in Pennsylvania, Maryland, Delaware, Virginia, and the District of Columbia.

16. On August 9, 1989, the President signed into law the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"). Among other things, FIRREA significantly increased the capital requirements for thrift institutions, and subjected them to stringent reporting and examination requirements by the Office of Thrift Supervision ("OTS"). As emphasized in the SNFS Form 10-K for the fiscal year ended December 31, 1989, "[t]he FIRREA legislation and subsequent regulations will have far-reaching effects on the Savings and Loan Industry," by, for example, placing "new limitations on non-residential lending," and requiring 60% of a thrift's tangible assets to be maintained in "Qualified Thrift Investments."

17. Olde Discount maintains a research file on SNFS, consisting of press releases, newspaper articles and a few research reports, mostly prepared by other firms such as Wheat First Securities. That research file highlighted the recent mergers between several large regional banks, including Sovran Financial and Citizens and Southern, suggesting that such deals "spark heavy buying of bank stocks," and that Crestar (based in Virginia) might be seeking to expand its Mid-Atlantic presence. Most of the articles and reports (other than press releases) in the research file, however, are dated (1988 and 1989).

18. Olde Discount's own research department generated only three research reports on SNFS over the

course of 1989-1990. In a report dated July 21, 1989, it recommended SNFS stock (then selling at 6 3/4 – 7 1/4 per share) as a long-term investment with "steady dividend payments." The next Olde Discount research report, dated July 13, 1990, is a startling contrast: "After further evaluation of regional economic conditions, we believe SNFS may increase its provision for loan losses in Q3 or Q4. . . . This Mid-Atlantic area weakness has the potential to slow SNFS growth in coming months." In addition, the dividend might be reduced. The research report concluded that "at this juncture, SNFS currently has limited upside potential. For this reason, we are changing our rating of the stock to neutral." By this time, the price of the stock had fallen to 4 1/8-4 1/2 per share.

19. In an internal memorandum dated July 31, 1990, Olde Discount's research department painted an even gloomier picture, in light of an external audit being conducted by OTS. "[W]e expect that the OTS will require the company to take some actions that could affect its earnings and dividends in the second half of this year. Thus, we reinforce our neutral position on SNFS until negative market and governmental forces come to pass."

20. In a third research report dated September 27, 1990, Olde Discount changed its recommendation on SNFS stock to "Fully Valued," because OTS had ordered the thrift to increase its loan loss reserves by more than $25 million. Non-performing assets had increased from $30 to $62 million, and the board of directors had voted to suspend the quarterly dividend. The price of the stock had fallen even further, to 3-3 1/4 per share. As of September 30, 1990, the thrift had lost over $16 million during the three previous months alone.

21. By the end of 1990, the situation was worse. As reported in its Form 10-K for the fiscal year ended December 31, 1990, SNFS had failed to meet the core and risk-based capital requirements by $9.9 and $15.8 million, respectively. Because it was not in compliance with regulatory capital requirements, it was required to submit a capital plan to OTS. As noted by the thrift's independent auditors, "[f]ailure to meet the capital requirements and interim capital targets included in the Company's capital plan exposes the Company to regulatory sanctions, including regulatory take-over."

The Delaware Investors

22. Eugene H. Engelhardt and Carol D. Engelhardt are, and have been for all times relevant to this Notice, residents of the State of Delaware. In 1983, the Engelhardts opened a joint account with Olde Discount in Michigan, where they were then residing. When they moved to Delaware in 1986, they transferred their account to Olde Discount's Wilmington office. Their account was assigned to a series of account representatives, and ultimately to Donohoe. At the time, Donahoe [sic] was the only employee in Olde Discount's Wilmington branch; he was both a registered representative and the branch manager.

23. Mr. Engelhardt is 56 years old and a sales manager for the DuPont Company. His wife, who is not employed, is 50. Both of them have college degrees.

24. When Mr. Engelhardt opened an account with Olde Discount in 1983, he chose a discount broker because he did not want investment advice, but rather

preferred to trade a few times a year on securities that he selected. After the account was transferred to Delaware, he did not trade actively, except to purchase certificates of deposit and a few stocks.

25. In the spring of 1990, Mr. Engelhardt purchased stock in Northrop Corporation. When Mrs. Engelhardt stopped by the Olde Discount branch office in Wilmington to drop off the check, Donohoe tried to convince her to buy stock with her own money, as opposed to with her husband. Later, Donohoe called Mr. Engelhardt to recommend that he buy stock in SNFS. When Mr. Engelhardt did not express any interest, Donohoe began to badger him about making this investment. When Mr. Englehardt would telephone to check on his investment portfolio, Donohoe always pushed SNFS stock. Donohoe said that he knew the stock well, because it was a local bank, and Olde Discount's research report gave it a "big buy recommendation." Mr. Engelhardt told Donohoe that he preferred to keep most of his money in CDs.

26. Donohoe, nevertheless, continued to pressure Mr. Engelhardt to buy SNFS stock, telling him that "it was a real good bank" and that he (Donohoe) had "inside knowledge" that it was about to be bought by another bank. Donohoe also said that SNFS paid good dividends, which would pay him more than the interest the Engelhardts were receiving on their CDs.

27. When Mr. Engelhardt told Donohoe that he still was not interested, Donohoe said that in order to make the sale, "I'll even waive the commission." Finally convinced, Mr. Engelhardt decided to buy.

28. On May 15, 1990, the Engelhardts bought 2,000 shares of SNFS stock at 5 1/4 per share for $10,622. On that same day, they also purchased an additional 3,000 shares at 5 3/8 for $16,308. Both confirmation tickets marked the transactions as "unsolicited."

29. In connection with these offers and sales of a security, Donahoe [sic] and Olde Discount (through its agent Donohoe) made untrue statements of material fact, or omitted to state material facts, in violation of 6 *Del C.* Sections 7303(2) and 7316(a)(2).

(1) Among the untrue statements made to the Engelhardts were:

(a) Donohoe had inside knowledge that SNFS was about to be purchased by another bank;

(b) SNFS would pay more in dividends than they were earning in interest on bank instruments; and

(c) Donohoe would waive any commission on the sale.

(2) Among the material facts Donohoe failed to disclose were:

(a) Olde Discount was a market-maker for SNFS stock;

(b) Olde was selling SNFS stock in the capacity as a principal, not as an agent; and

(c) The potential effects of FIRREA and federal thrift regulations on the business and profitability of SNFS.

30. In connection with these offers and sales of a security, Donohoe and Olde Discount engaged in dishonest or unethical business practices in violation of 6 *Del C.* Section 7316(a)(7) by: (1) failing to do a proper due diligence check with regard to this security; and (2) noting on the confirmation statements that the sales were "unsolicited," when in fact they were solicited by Donohoe. Olde Discount's own Compliance Manual provides that "[a]ll solicited trades must be noted as 'solicited' when the order is entered into the computer system. It is a violation of Section 204 of the Uniform Securities Act for a registered representative to mark a trade as 'unsolicited' when in fact the transaction was solicited."

31. In addition, Olde Discount failed reasonably to supervise its agent, Donohoe, in connection with the offers and sales of that security, in violation of 6 *Del. C.* Sections 7316(a)(10).

32. After the initial sales, Donohoe continued to pursue the Engelhardts to purchase more SNFS shares. He said that a "round lot" of 10,000 shares would be easier to sell. He also recommended buying more of the stock because he claimed the thrift was "strong, "in good shape," would continue to pay good dividends." Again, he suggested that he knew of "things going on," alluding to a potential acquisition of SNFS by another bank, which would make this "a really good deal."

33. On Donohoe's recommendation, the Engelhardts bought another 5,000 shares of Second National stock on June 6, 1990 at 5 1/4 per share for $26,250. Again the confirmation ticket marked the transaction as "unsolicited."

34. In connection with this offer and sale of a security, Donohoe and Olde Discount (through its agent Donohoe) made untrue statements of material fact, or omitted to state material facts, in violation of 6 *Del C.* Sections 7303(2) and 7316(a)(2).

(1) Among the untrue statements made to the Engelhardts were:

(a) Donohoe had inside knowledge that SNFS was about to be purchased by another bank;

(b) SNFS would continue to pay good dividends; and

(c) The thrift was "strong" and in "good shape."

(2) Among the material facts Donohoe failed to disclose were:

(a) Olde Discount was a market-maker for SNFS stock;

(b) Olde was selling SNFS stock in the capacity as a principal, not as an agent; and

(c) The potential effects of FIRREA and federal thrift regulations on the business and profitability of SNFS.

35. In connection with this offer and sale of a security, Donohoe and Olde Discount engaged in dishonest or unethical business practices in violation of 6 *Del C.* Section 7316(a)(7) by: (1) failing to do a proper due diligence check with regard to this security; and (2) noting on the confirmation statement that the sale was "unsolicited," when in fact it was solicited by Donohoe.

36. In addition, Olde Discount failed reasonably to supervise its agent, Donohoe, in connection with the offers and sales of that security, in violation of 6 *Del. C.* Sections 7316(a)(10) and 7316(a)(2).

37. Despite the public information that came out about SNFS shortly after the Engelhardts purchased their stock – as reflected in Olde Discount's own research files and internal memoranda – neither Donohoe nor anyone else from Olde Discount made any effort to keep the Engelhardts abreast of their investment so as to allow them to make an informed decision whether to hold on or cut their losses by selling. Indeed, even though Mr. Engelhardt called Donohoe in July 1990 because he was concerned about the drop in the price of his stock, Donohoe told [sic] encouraged him to hold on to it because it would turn around. Nor did Donohoe ever call the Engelhardts to apprise them of new information pertinent to their investment. This was in violation of Olde Discount's own Compliance Manual, which provides: "If a client owns a Special Ventures Security, the broker should contact the client when new information on that Special Ventures Security appears on the computer terminal or when information is received in the overnight mail."

38. Mr. Engelhardt also complained to Olde Discount's home office in Michigan to one of the firm's vice presidents in July 1990. She said that she would look into the matter, but when Mr. Engelardt [sic] had not heard anything in some time, he called her back. She said that she had talked with Donohoe, and concluded that he had done nothing wrong.

39. The securities transactions described above occurred in the State of Delaware and involved investors who are Delaware residents.

40. Respondents have collectively committed at least fifteen separate violations of the Act.

41. It is in the public interest that the broker-dealer registration of Olde Discount be suspended or revoked.

42. It is in the public interest that Donohoe be permanently barred from engaging in the securities business in Delaware.

43. It is in the public interest that the respondents rescind the two sales of SNFS stock to the Englehardts, and pay them back their purchase price of $52,875.

44. It is also in the public interest that the respondents be fined $1,000 for each and every violation of the Act, and that they pay all of the costs incurred by the Division in connection with the investigation and prosecution of this case.

Dated: August 17, 1992

/s/ W. Michael Tupman
W. MICHAEL TUPMAN
Deputy Attorney General

BEFORE THE SECURITIES COMMISSIONER
OF THE STATE OF DELAWARE

IN THE MATTER OF:	)	
	)	
OLDE DISCOUNT CORP. and MICHAEL R. DONAHOE,	)	Case No. 91-07-01
	)	
Respondents.	)	
	)	

ORDER

Upon the authority of 6 *Del. C.* Section 7316(c), it is hereby ordered that a hearing shall be held on the foregoing charges if written requests by the respondents are received in my office within thirty (30) days of the date of this Order. If no request for a hearing is received from any particular respondent, the foregoing allegations shall be deemed to have been admitted by that individual or entity, and I will issue a final order of suspension, revocation, rescission, fine, and/or costs against that individual or entity.

/s/ Richard W. Hubbard
RICHARD W. HUBBARD
Securities Commissioner

Dated: August 17, 1992

ADDITIONAL PROVISIONS OF THE DELAWARE SECURITIES ACT, IN PERTINENT PART

6 Del. Code Ann. § 7301:

Sec. 7301. Short title – Purpose. (a) This chapter shall be known and may be cited as the "Delaware Securities Act."

(b) The purpose of the Delaware Securities Act is to prevent the public from being victimized by unscrupulous or overreaching broker-dealers, investment advisers or agents in the context of selling securities or giving investment advice, as well as to remedy any harm caused by securities law violations. This prophylactic and remedial purpose shall be deemed of paramount importance in the interpretation of the provisions of this Act and particularly in any judicial review of sanctions or penalties imposed by the Securities Commissioner and of motions or requests by persons affected to stay such sanctions or penalties.

6 Del. Code Ann. § 7316(a) & (g):

Sec. 7316. Denial, revocation, suspension, cancellation and withdrawal of registration of broker-dealers, investment advisers and agents. (a) The Commissioner may by order deny, suspend, or revoke any registration if he finds that the order is in the public interest and that the applicant or registrant or, in the case of a broker-dealer or investment adviser, any partner, officer, director, or any person occupying a similar status or performing similar functions, or any person directly or indirectly controlling the broker-dealer or investment adviser:

(1) Has filed an application for registration which as of its effective date, or as of any date after filing in the case of an order denying effectiveness, was incomplete in any material respect or contained any statement which was, in light of the circumstances under which it was made, false or misleading with respect to any material fact; or

(2) Has wilfully violated or wilfully failed to comply with any provision of this chapter; or

(3) Has been convicted of a felony, infamous crime, or other crime involving moral turpitude; or

(4) Is permanently or temporarily enjoined by any court of competent jurisdiction from engaging in or continuing any conduct or practice involving any aspect of the securities business; or

(5) Is the subject of an order of the Commissioner denying, suspending, revoking registration as a broker-dealer, investment adviser or agent; or

(6) Is the subject of an order entered within the past 10 years by the securities administrator of any other State or by the Securities and Exchange Commission either ordering the person to cease and desist from engaging in or continuing any conduct or practice involving any aspect of the securities business, or suspending, denying or revoking registration as a broker-dealer, investment adviser or agent, or the substantial equivalent of those terms as defined in this chapter; or is suspended or expelled from a national securities exchange or national securities association registered under the Securities

Exchange Act of 1934 either by action of a national securities exchange or national securities association, the effect of which action has not been stayed by administrative or judicial order; or is the subject of a United States Post Office fraud order; or

(7) Has engaged in dishonest or unethical practices within or outside this State; or

(8) Is insolvent, either in the sense that his liabilities exceed his assets or in the sense that he cannot meet his obligations as they mature; or

(9) Is not qualified on the basis of such factors as training, experience, and knowledge of the securities business, except as otherwise provided in subsection (b); or

(10) Has failed reasonably to supervise his agents if he is a broker-dealer or investment adviser, or an agent with supervisory responsibilities, and the Commissioner may infer such failure from an agent's violations; or

(11) Has failed to pay the proper filing fee, but the Commissioner shall vacate any denial or suspension order when the deficiency has been corrected; or

(12) Has violated or failed to comply with any lawful order issued by the Commissioner; or

(13) Has within the past 10 years been a partner, officer, director, controlling person, or any person occupying a similar status or performing similar functions, in a broker-dealer or investment adviser whose registration in this State or any State, or with the Securities and Exchange Commission, has been revoked for disciplinary reasons, or whose membership in a national securities

exchange or national securities association has been terminated for disciplinary reasons.

(g) The Commissioner shall, upon notice and hearing as further defined by subsection (c) of this section, have the right to fine any broker-dealer, investment adviser or agent in an amount not to exceed $10,000 for each and every violation of this chapter, plus the costs of investigation and prosecution.

6 Del. Code Ann. § 7320:

Sec. 7320. Injunctions. Whenever it appears to the Commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this chapter or any rule or order hereunder, he may in his discretion bring an action in the Court of Chancery to temporarily restrain or to enjoin the acts or practices and to enforce compliance with this chapter or any rule or order hereunder. The Commissioner may also seek, and the Court of Chancery shall upon proper showing grant, such other ancillary relief as is in the public interest including the appointment of a receiver, temporary receiver, conservator, obtaining of an accounting, orders of rescission, orders of restitution, or other relief as may be appropriate in the public interest. The Court shall not require the Commissioner to post a bond.

6 Del. Code Ann. § 7322:

Sec. 7322. Criminal penalties. (a) Fraud of $50,000 or more; Class E Felony. Any person who wilfully violates

section 7303 of this chapter, thereby causing any investor or investors to lose $50,000 or more, shall upon conviction be fined not more than $200,000 or imprisoned not more than 5 years at Level V incarceration, or both, per violation.

(b) Fraud of $10,000 or more; Class F Felony. Any person who wilfully violates section 7303 of this chapter, thereby causing any investor or investors to lose $10,000 or more, though less than $50,000, shall upon conviction be fined not more than $100,000 or imprisoned not more than 3 years at Level V incarceration, or both, per violation.

(c) Other Violations; Class G Felony. Any person who wilfully violates any provision of this chapter, and whose offense is not covered by subsections (a) or (b) above, shall upon conviction be fined not more than $100,000 or imprisoned not more than 2 years at Level V incarceration, or both, per violation.

(d) No indictment or information may be returned under this chapter more than 5 years after the alleged violation. The Superior Court shall have exclusive jurisdiction of any criminal violations of this chapter.

(e) In addition to the penalties stated above, restitution to any investor or investors may be ordered. Nothing in this chapter limits the power of the State to punish any person for any conduct which otherwise constitutes a crime by statute.

6 Del. Code Ann. § 7323:

Sec. 7323. Civil liabilities. (a) Any person who:

(1) Offers or sells a security in violation of § 7313 or § 7304 or any order under § 7308 of this title, or

(2) Offers, sells or purchases a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they are made, not misleading (the buyer or seller not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known of the untruth or omission, is liable to the person buying or selling the security from or to him, who may sue either at law or in equity to recover the consideration paid for the security, together with the interest at the legal rate from the date of payment costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security.

(b) Every person who directly or indirectly controls a seller or buyer liable under subsection (a), every partner, officer, or director of such a seller or buyer, every person occupying a similar status or performing similar functions, every employee of such seller or buyer who materially aids in the sale, and every broker-dealer or agent who materially aids in the sale or purchase are also liable jointly and severally with and to the same extent as the seller or buyer, unless the non-seller or non-buyer who is so liable sustains the burden of proof that he did not know, and in exercise of reasonable care could not

have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.

(c) Any tender specified in this section may be made at any time before entry of judgment.

(d) Every cause of action under this chapter survives the death of any person who might have been a plaintiff or defendant.

(e) No person may sue under this section more than 3 years after the contract of sale. No person may sue under this section if the buyer received a written offer, before suit and at a time when he owned the security, or if a seller received a written offer before suit, to refund the consideration paid together with interest at the legal rate from the date of payment, less the amount of any income received on the security, and he failed to accept the offer within [30 days] of its receipt, or if the buyer received such an offer before suit and at a time when he did not own the security, unless he rejected the offer in writing within [30 days] of its receipt.[1]

(f) No person who has made or engaged in the performance of any contract in violation of any provision of this chapter or any rule or order hereunder, or who has acquired any purported right under any such contract

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[1] 68 Del. Laws, c. 181, purported to delete "30 days" in (e), but made no substitution instead of that term. This was due to a typographical error in the bill that was unfortunately adopted by the Code Revisers. The term "30 days" is probably still valid.

with knowledge of the facts by reason of which its making or performance was in violation may base any suit on the contract.

(g) Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this chapter or any rule or order hereunder is void.

(h) The rights and remedies provided by this chapter are in addition to any other rights or remedies that may exist at law or in equity.